

The Great Stagnation?

What Britain can learn from the declining fortunes of the American middle class

21 November 2011

Resolution Foundation

www.livingstandards.org

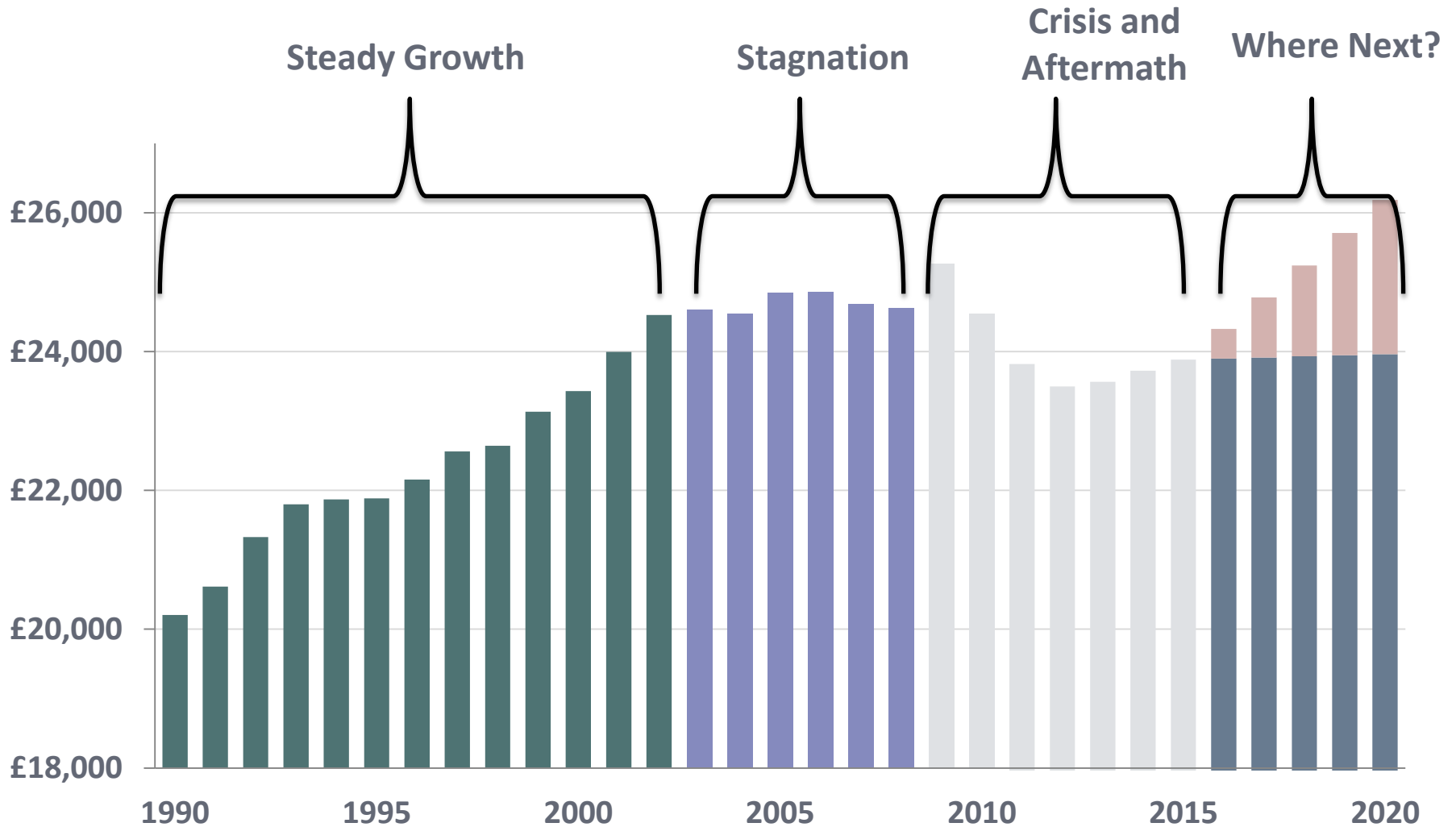
The Great Stagnation?

The UK context on living standards

Gavin Kelly, Chief Executive
Resolution Foundation

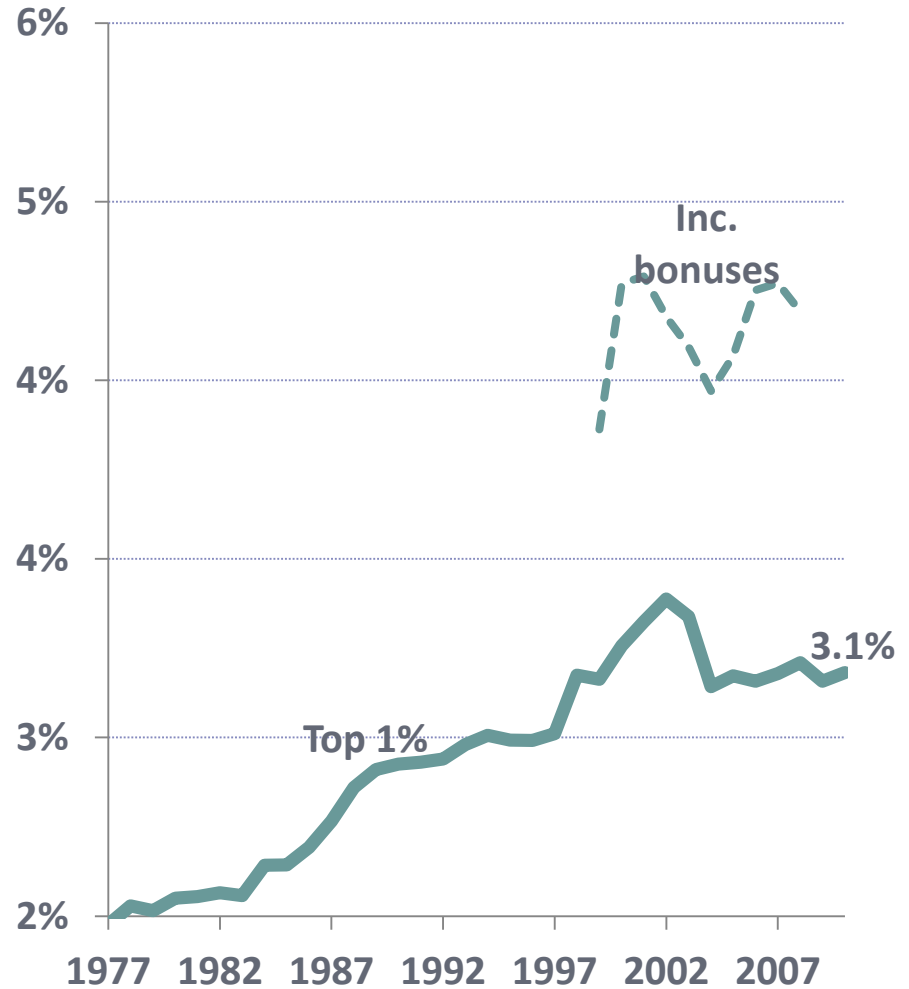
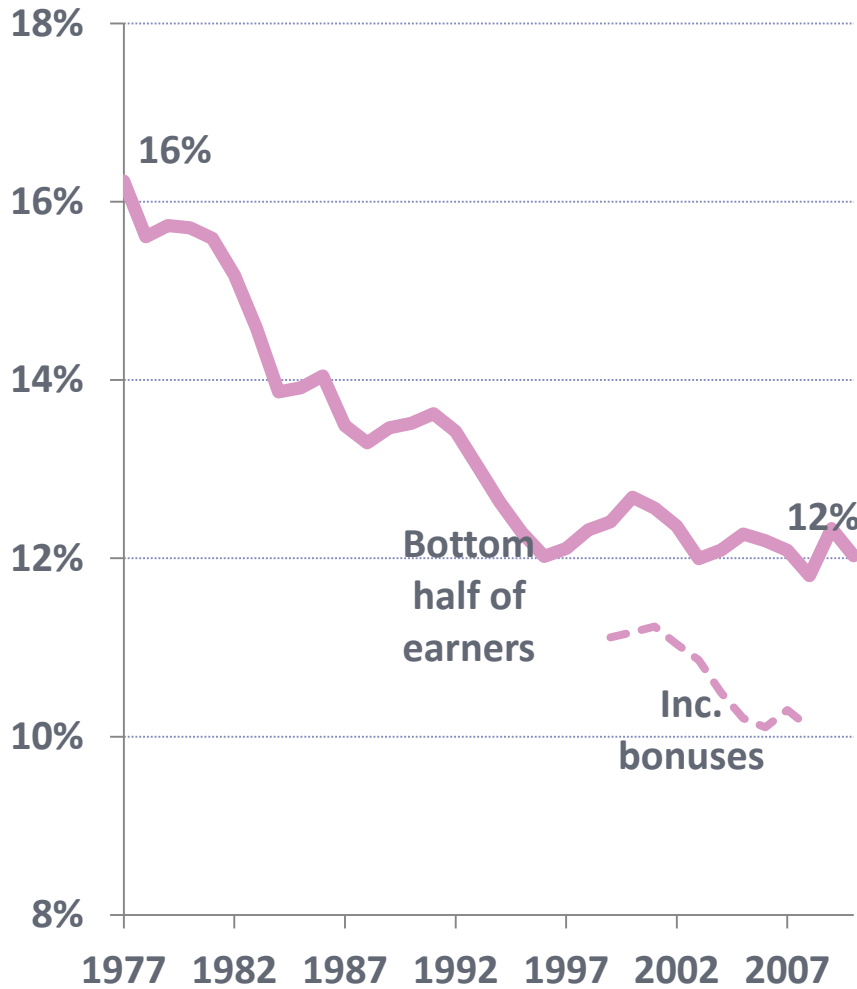
More than a lost decade for wages – where next?

Median wages (real)



Source: Resolution Foundation

The share of GDP going to low-to-middle earners has steadily declined

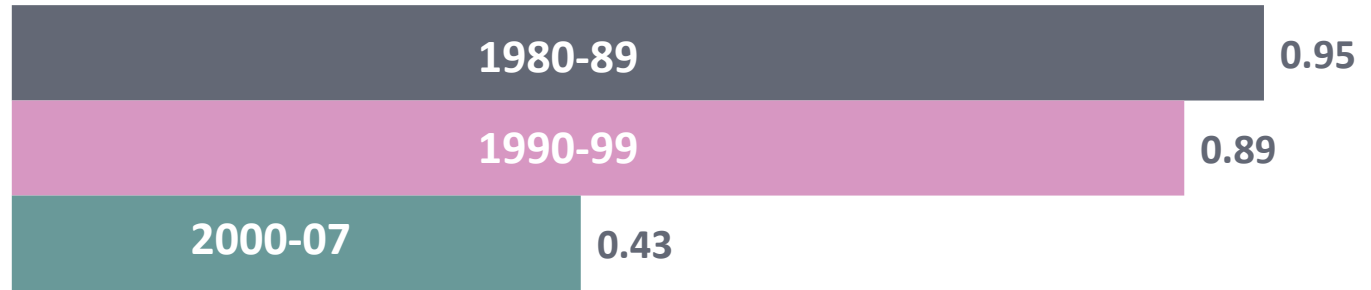


Source: Resolution Foundation

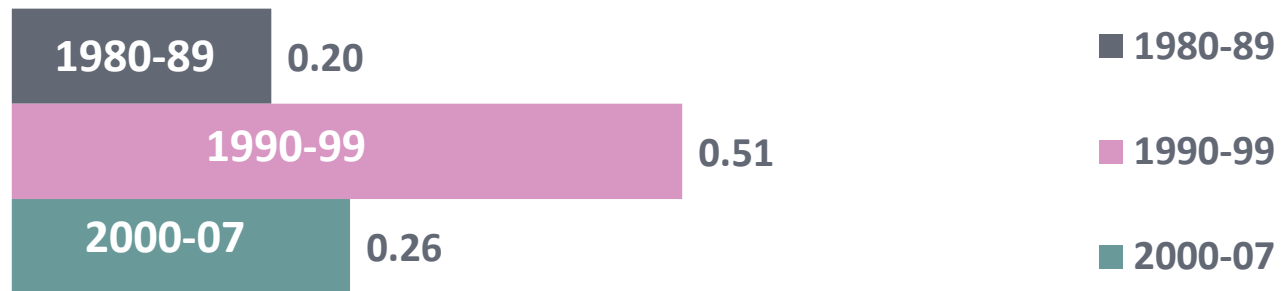
How well does growth feed through into higher median wages?



UK



US



1.0 = median pay moves exactly in line with GDP

Raising major questions about the source of future increases in living standards

- **Real wages**
 - return to steady growth or continued stagnation?
- **Employment levels**
 - reversing the trend in male employment and avoiding a fall in female employment?
- **Tax credits and benefits**
 - sharp reductions already in motion

Crunch: The American Middle Class Squeeze and What Others Can Learn From It

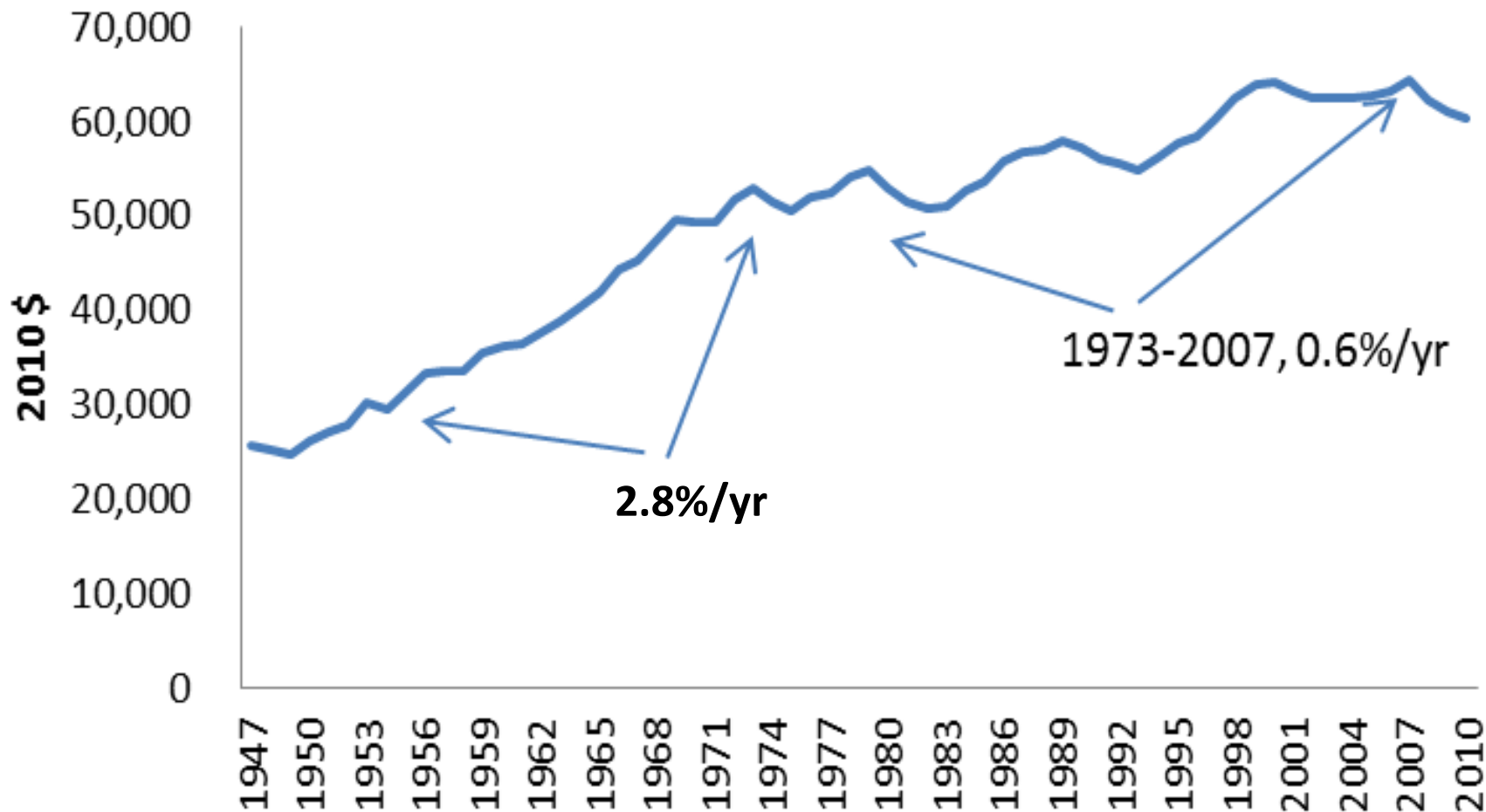
Jared Bernstein

Center on Budget and Policy Priorities

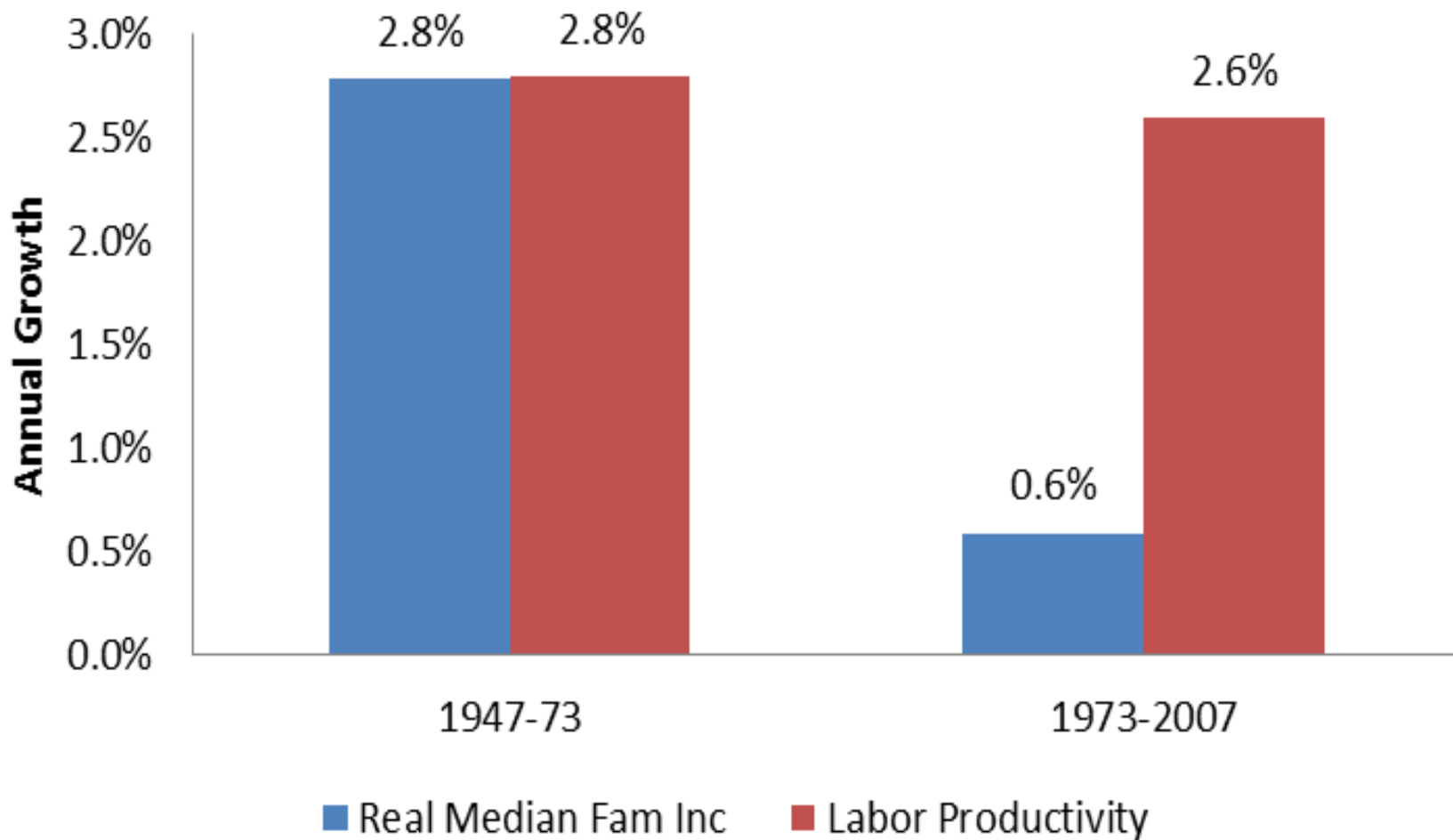
Washington, DC

bernstein@cbpp.org

Real Median Family Income, US



Real Median Inc, Productivity, 1973-2007



Source: Census, BLS

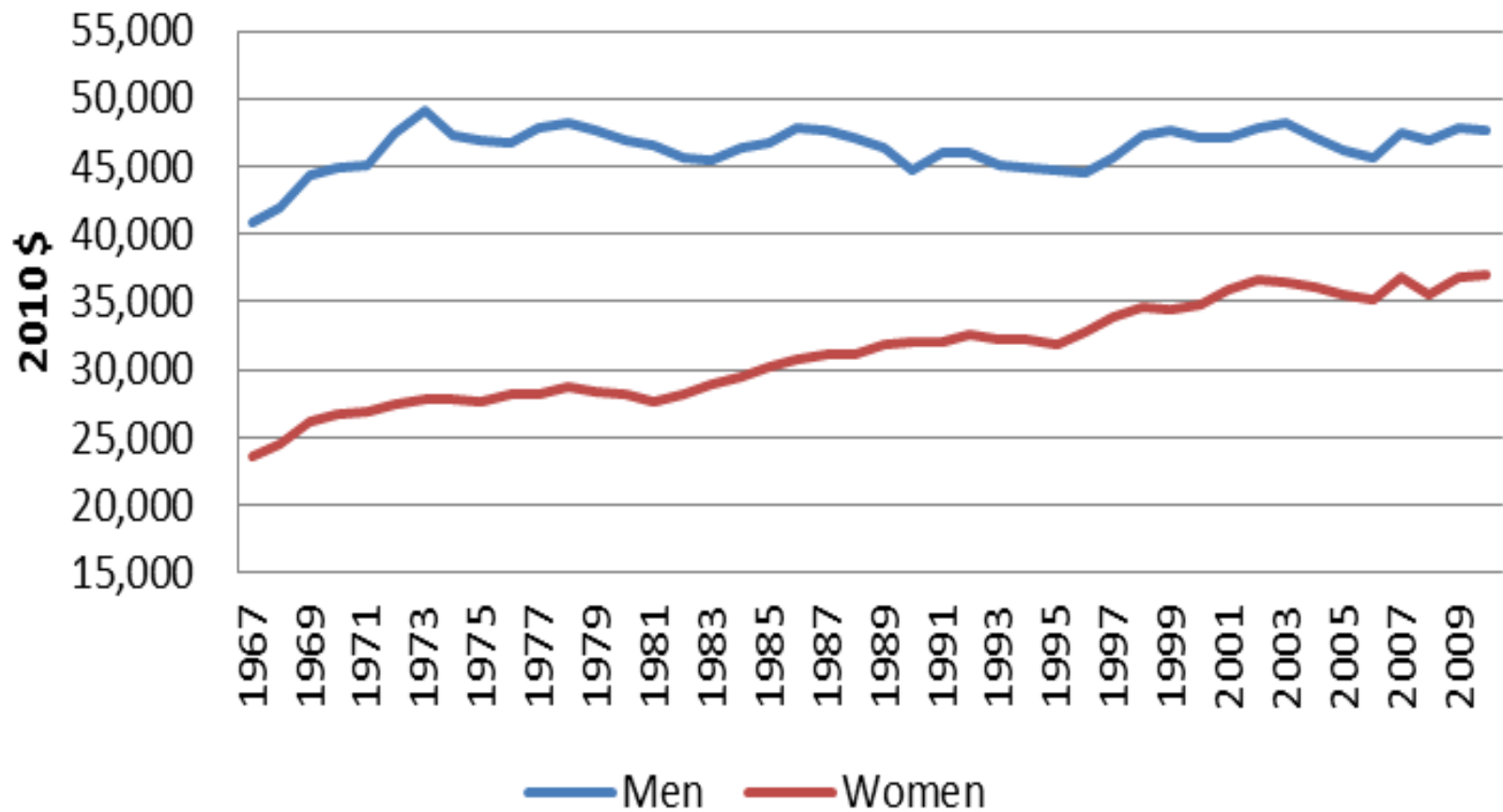
Real Income for Working-Age Households Reaches Lowest Level Since 1994

Non-elderly median household income (2010 dollars)



Sources: U.S. Census Bureau, National Bureau of Economic Research

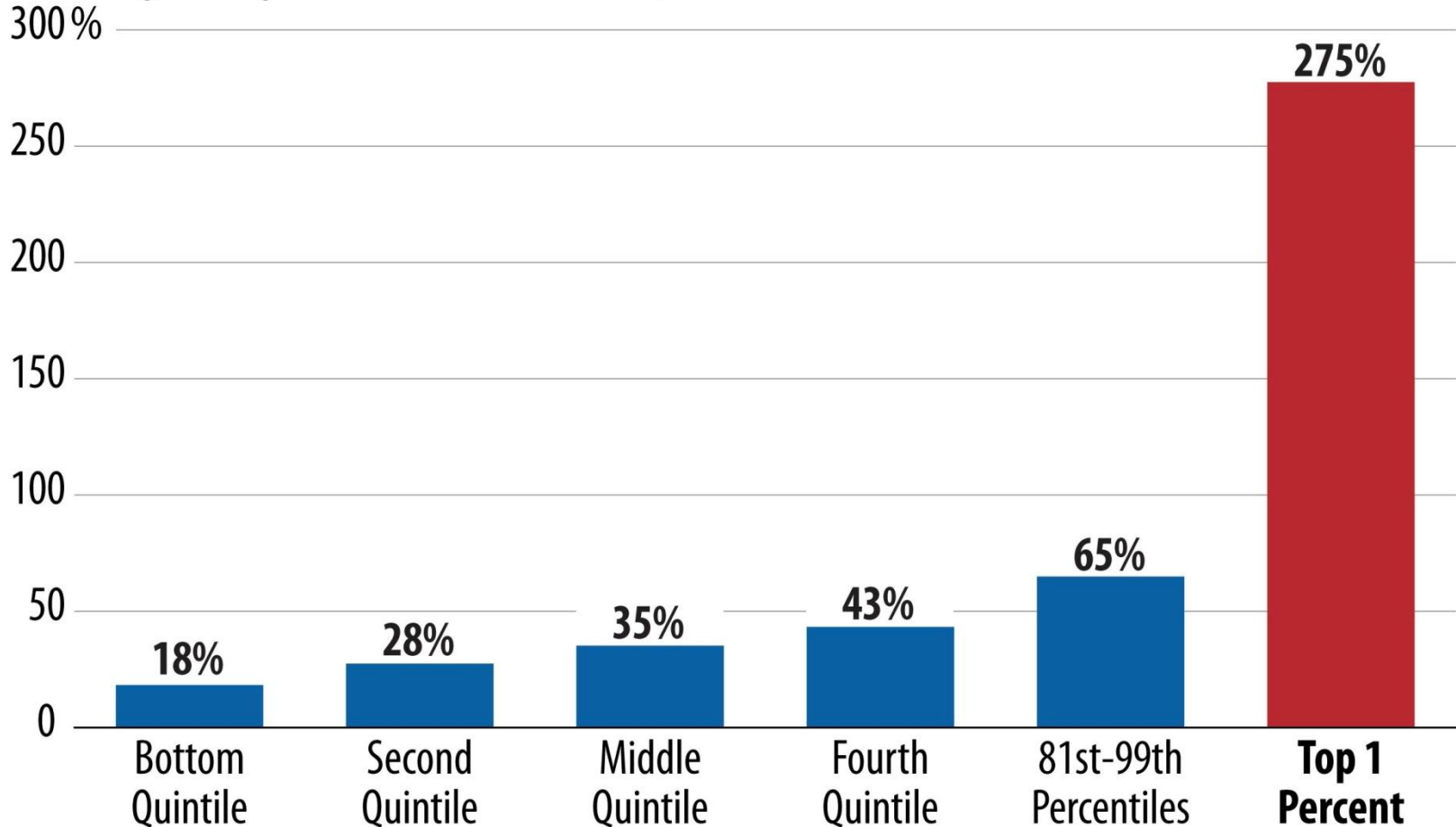
FT/FY Real Median Earnings by Gender, 1967-2010



Source: US Census Bureau

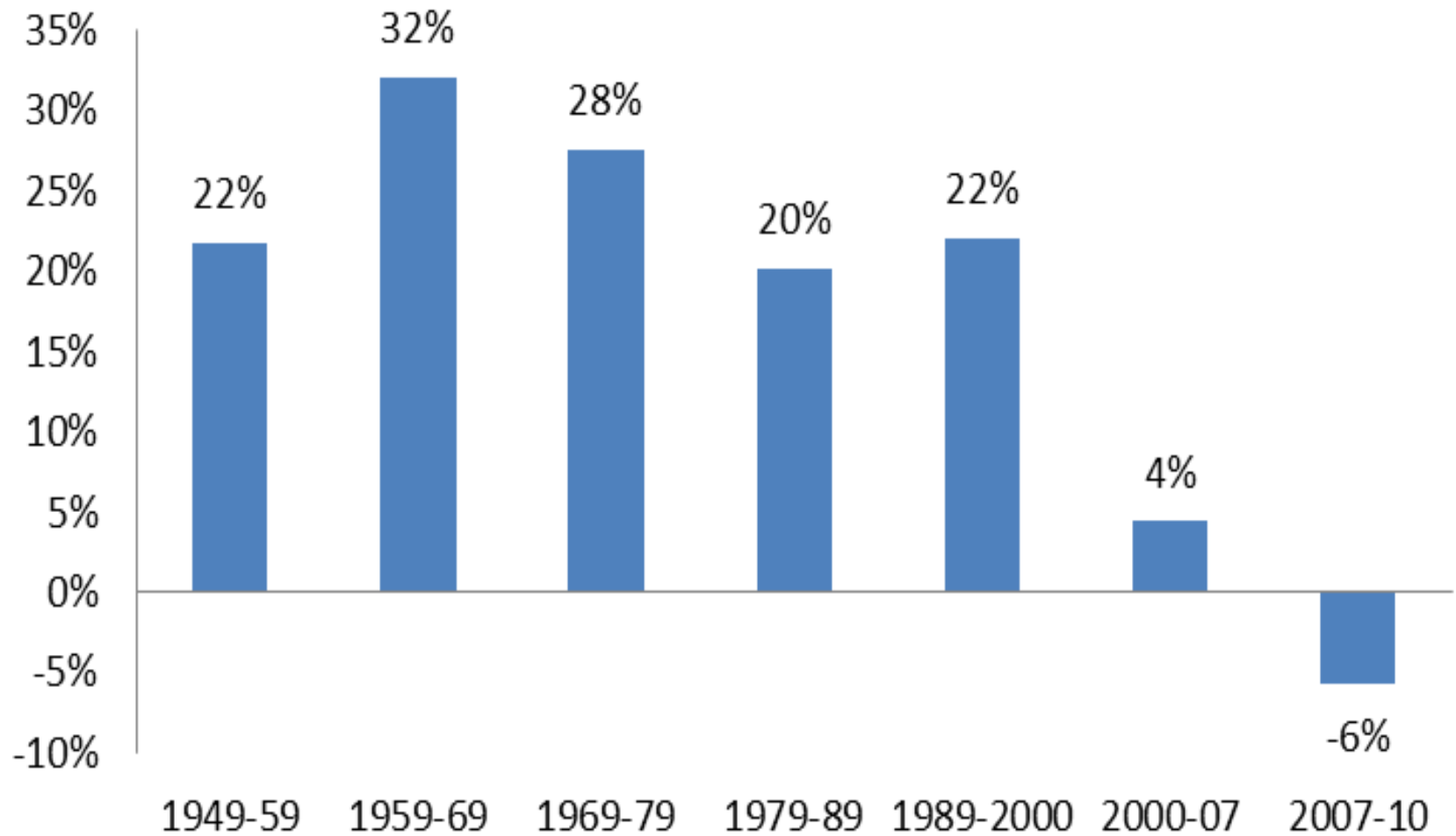
Income Inequality Has Increased Sharply in Recent Decades

Percentage Change in Real After-Tax Income, 1979-2007



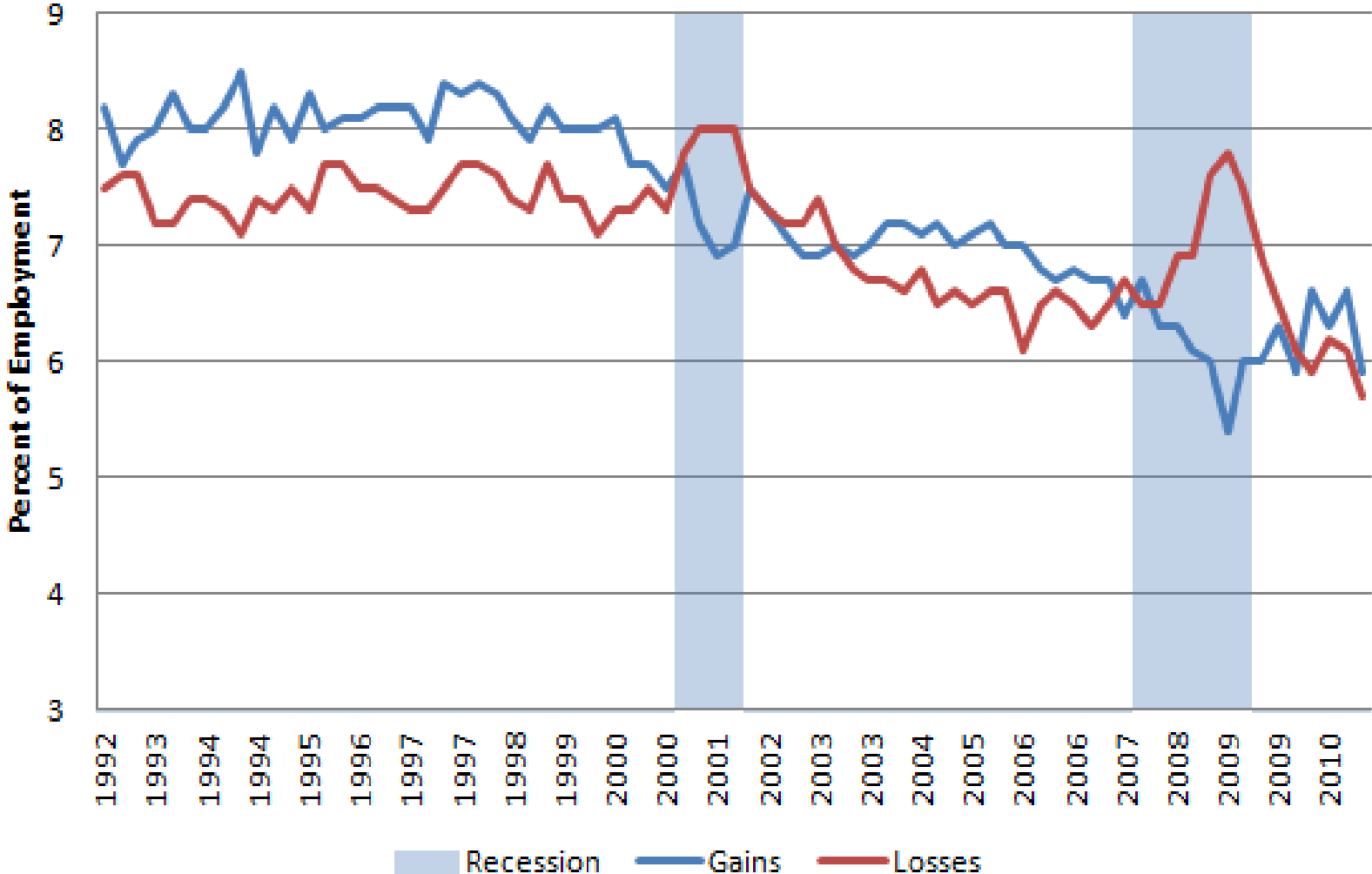
Source: Congressional Budget Office

Employment Growth, 1949-2010



Source: BLS

Gross Job Gains and Losses, 1992-2011



Source: BLS

Chart 6. Quarterly employment gains and losses resulting from private sector establishment births and deaths, 1993–2010

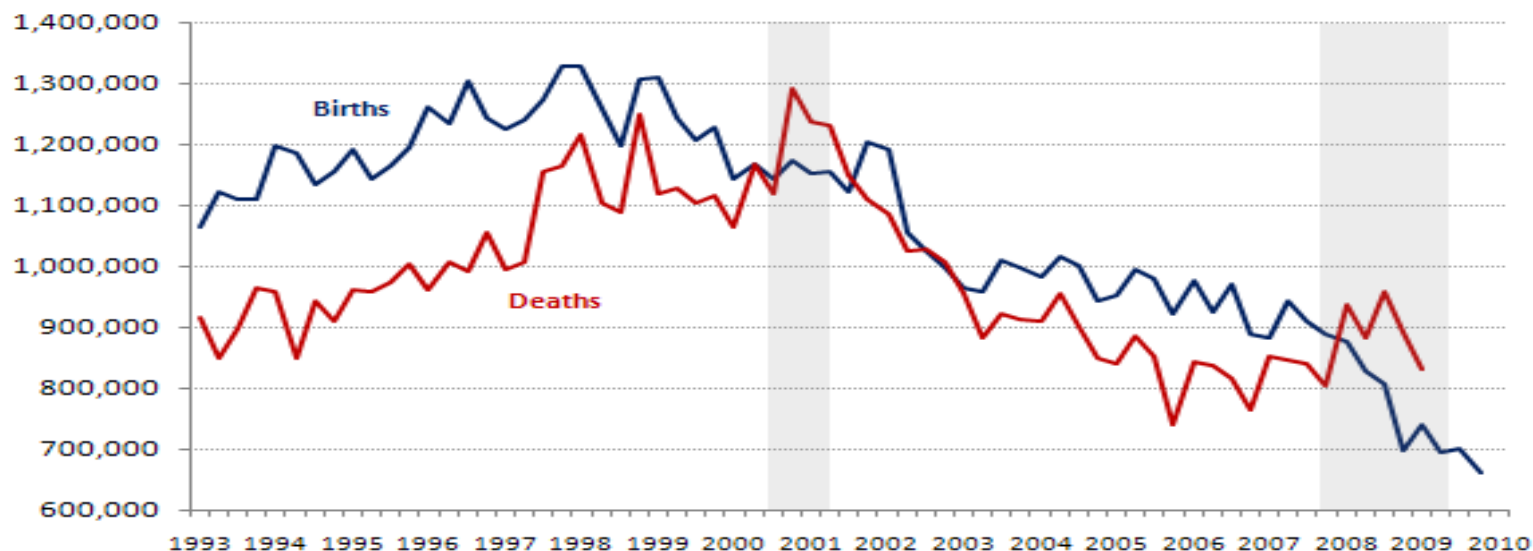
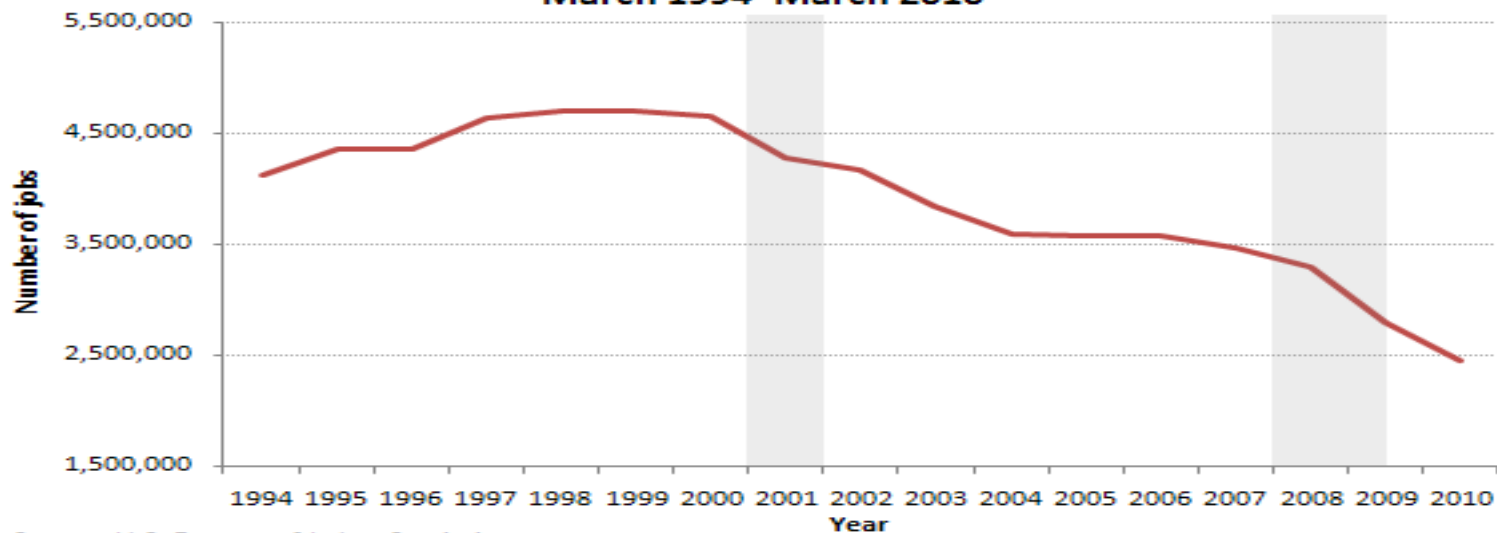


Chart 2. Jobs created by establishments less than 1 one year old, March 1994–March 2010



Source: U.S. Bureau of Labor Statistics

4%?!...What Happened?

- Acceleration of Labor Saving Technology?
- Increased Import Penetration from China
- Allocative inefficiency
- Feedback from inequality, lousy middle-class income growth
- Absence of wage-led demand growth
- Short recovery
- Bad fiscal policy

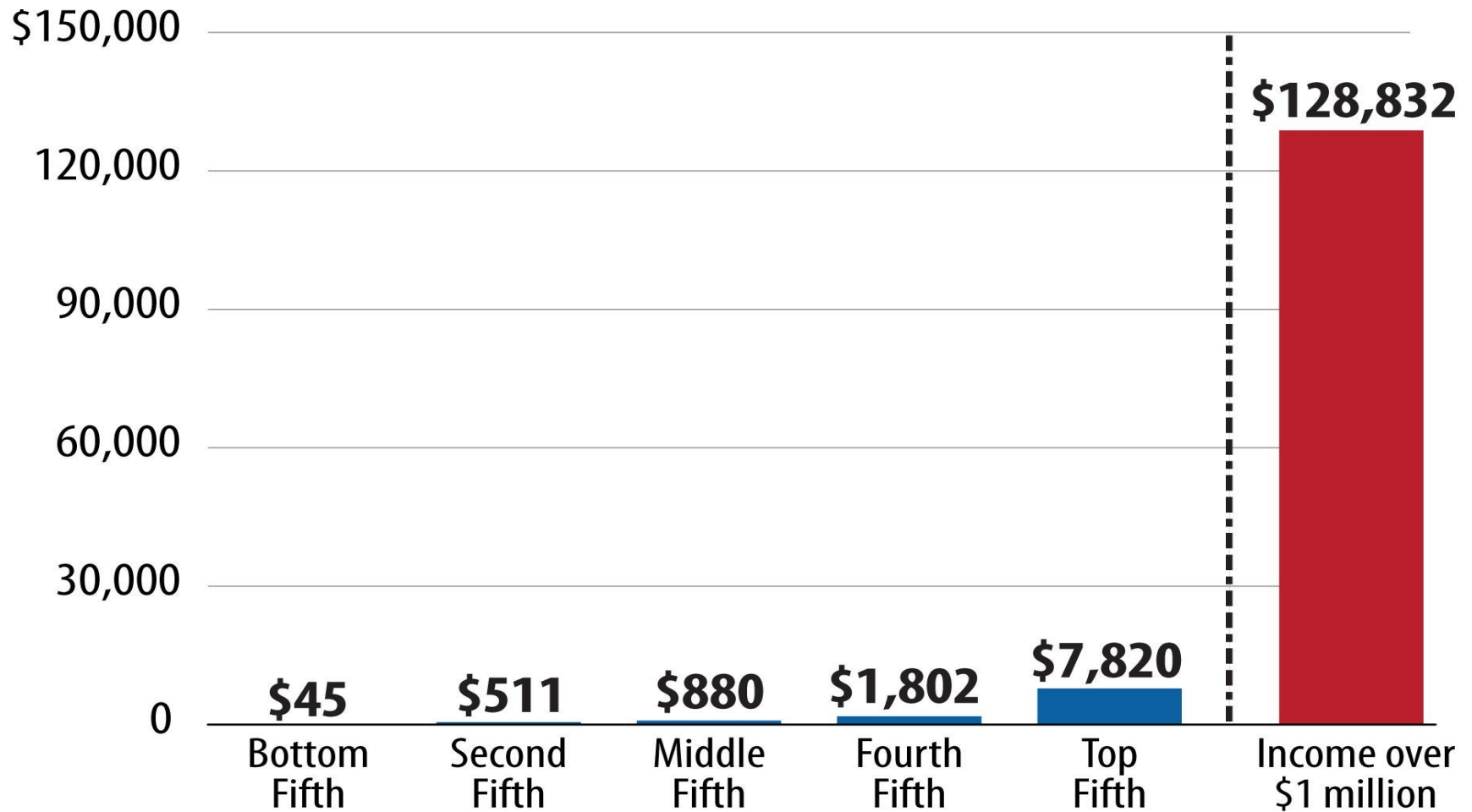
American Potholes, 1

- Markets self-regulate, “rationale expectations”
- Trickle-down, supply-side economics
- “We don’t pick winners!”
- We can neither spot nor deflate bubbles
- Small vs large businesses
- Mercantilists must be quietly nudged until they realize the errors of their ways
- Current events (stuck in wrong box)
- Fix it in the fisc (UK?)

AP 2, fiscal

- Government is the problem, YOYO economics
- Government failure as self-fulfilling prophecy
- Taxes can only be lowered; regressivity!
- Favoring different types of incomes
- Budget process totally non-transparent
- Lost some (not all) counter-cyclicality
- Process over product
- Misunderstanding of deficits and debt

Average Dollar Benefit From Extending All of the 2001 and 2003 Tax Cuts By Income Group

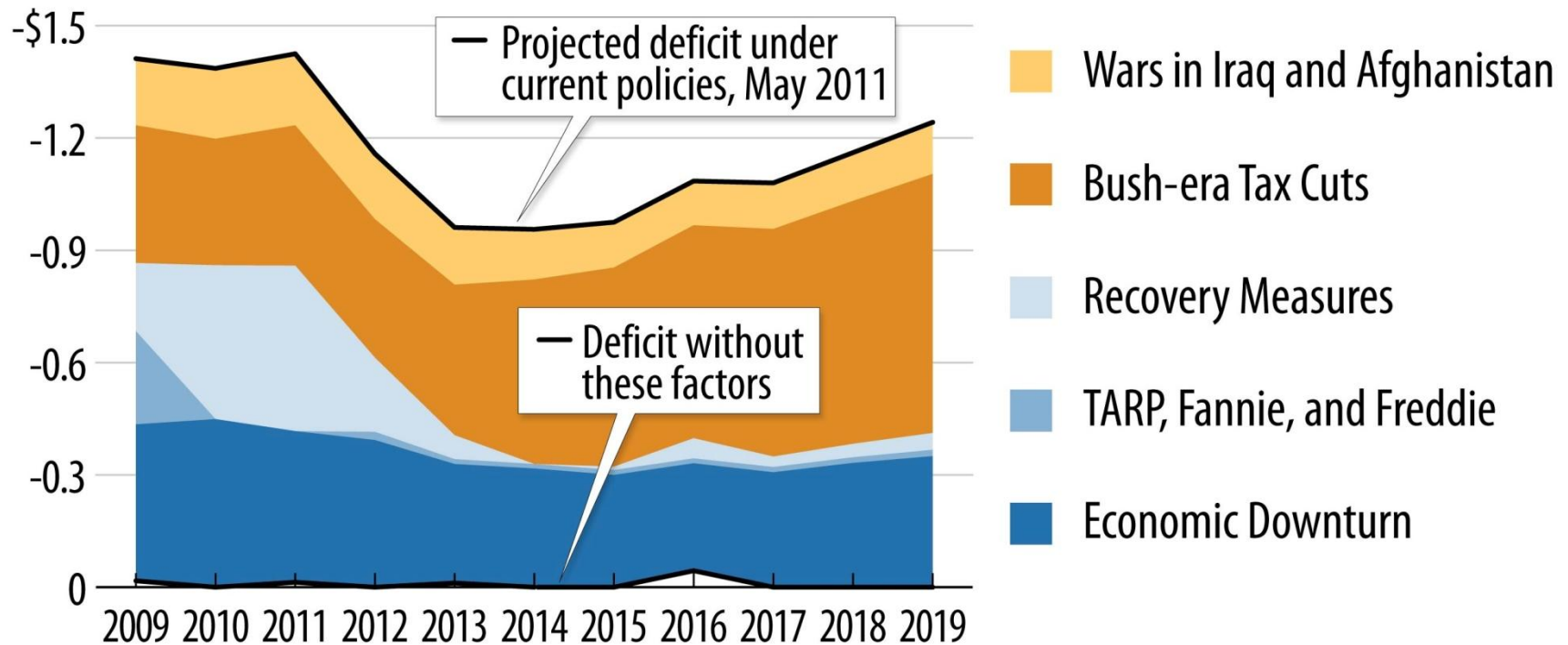


Misunderstanding of Public Borrowing

- Levels vs trends of debt/GDP
- What's are we borrowing for?
- Time horizons
- Little distinction in magnitudes
- Worst analogy ever/failure to defend Keynesianism
- Crowding out?

Economic Downturn and Legacy of Past Policies Drive Record Deficits in the Decade Ahead

Deficit, in trillions

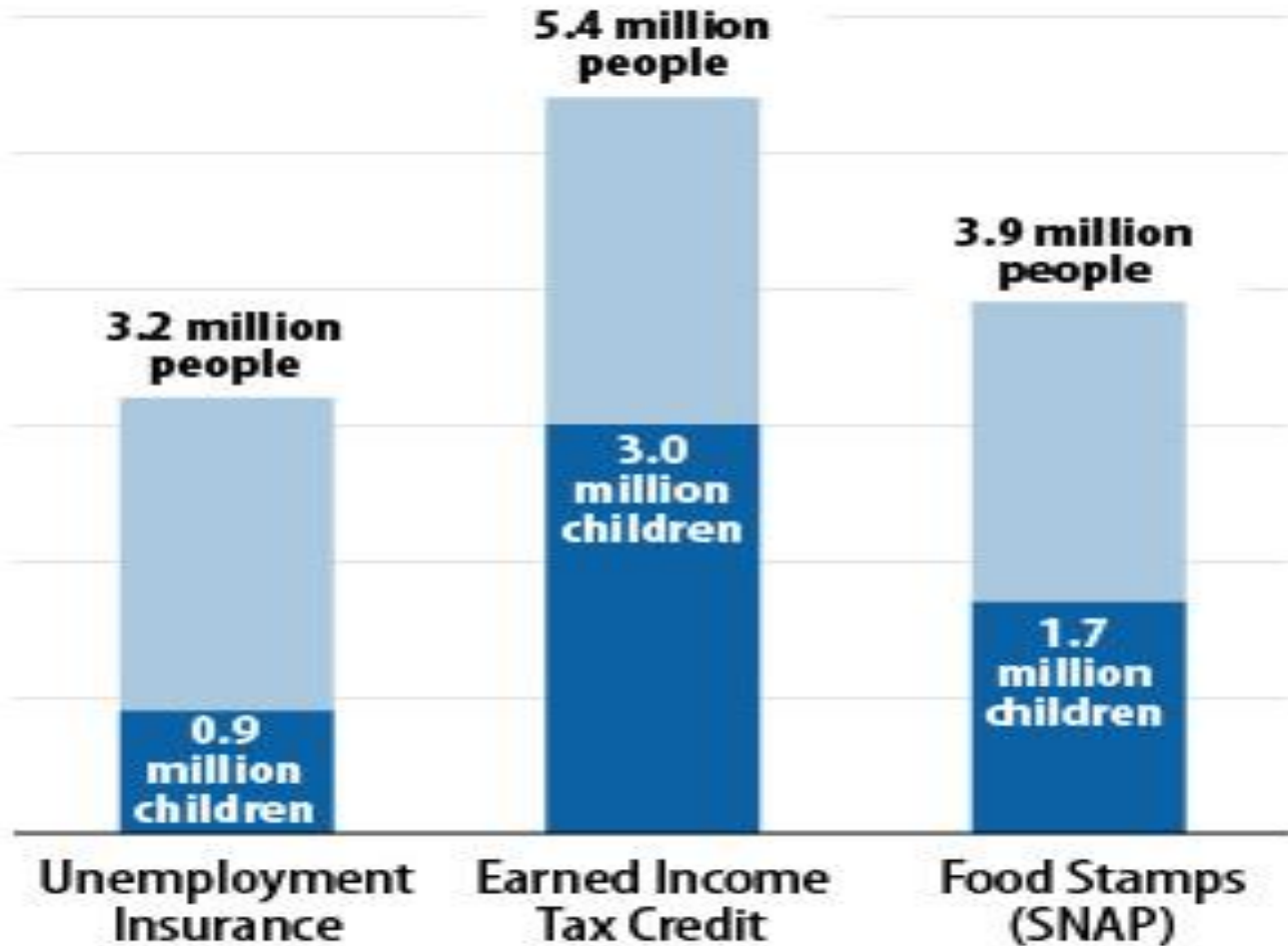


Stuff We've Done Right

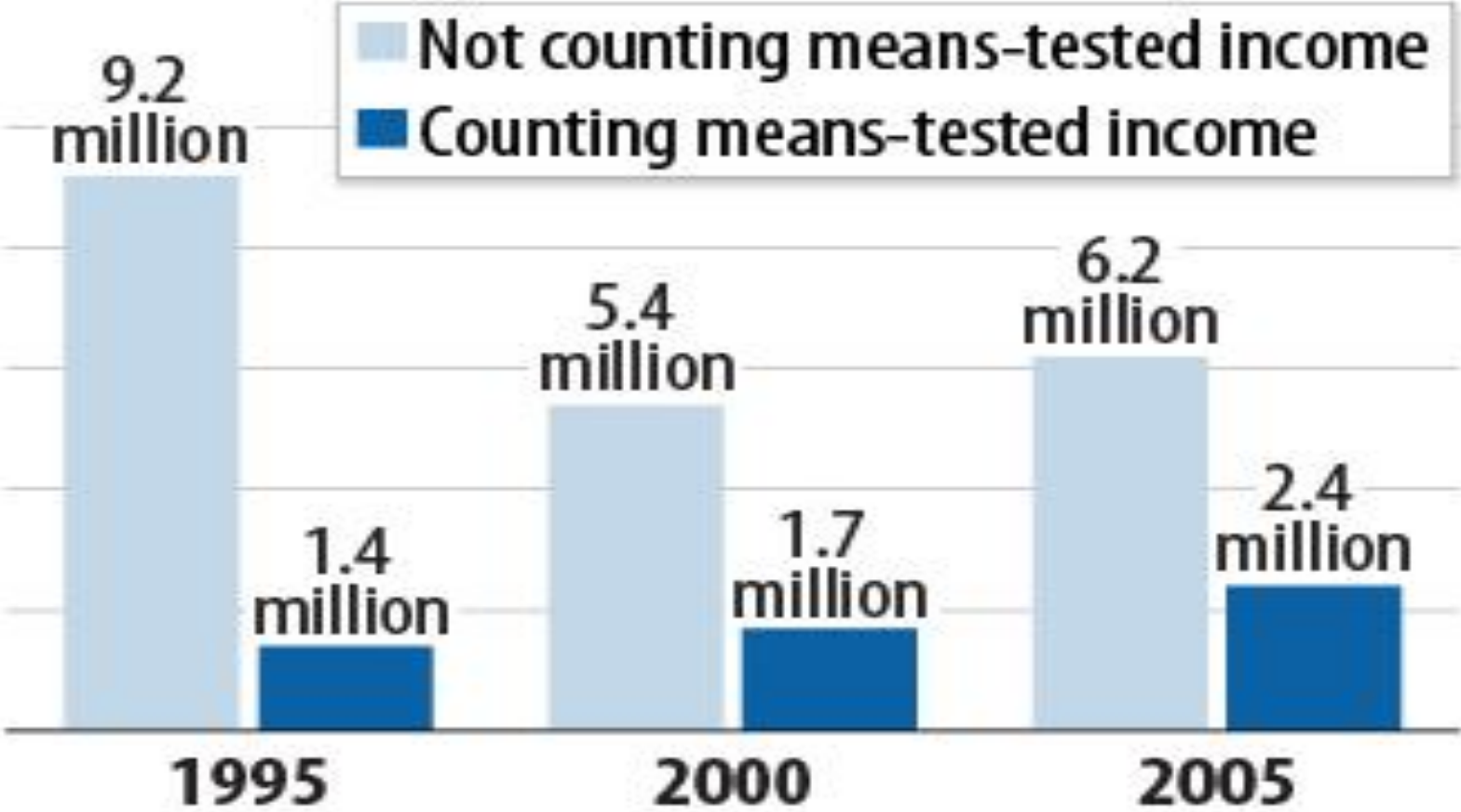
- Flexible capital and product markets
- Productivity acceleration, low NAIRU
- More significant poverty-reduction policies than typically recognized
- Skilled workforce; solid higher ed (but needs work); VC, entrepreneurs
- Creative Fed
- Late to the game, but hit back hard against market failure in great recession
- Growing interest in what's really going on and robust information markets

Government Programs Kept Millions Out of Poverty in 2010

People kept above the poverty line in 2010 when selected benefits are counted as income



Children Below *Half* the Poverty Line Before and After Considering Means-Tested Benefits



Source: CBPP analysis of the Current Population Survey; additional data from HHS TRIM model.

TANF Lifts Many Fewer Children out of Deep Poverty than AFDC Did

TANF (2005)

Lifted 21% of children who otherwise would have been in deep poverty

 **650,000**
children

AFDC (1995)

Lifted 62% of children who otherwise would have been in deep poverty

 **2,210,000**
children

Conclusion

- We in the US appear may have missed an opportunity to implement new economic model
- Tailrisk is more important than even: market failure, health care, financial regulation, quantity/quality of jobs, inequality—all fodder for public policy—the squeeze is a function of market outcomes
- The US revenue trap
- Be wary of process solutions

Lessons from the U.S. and other rich nations

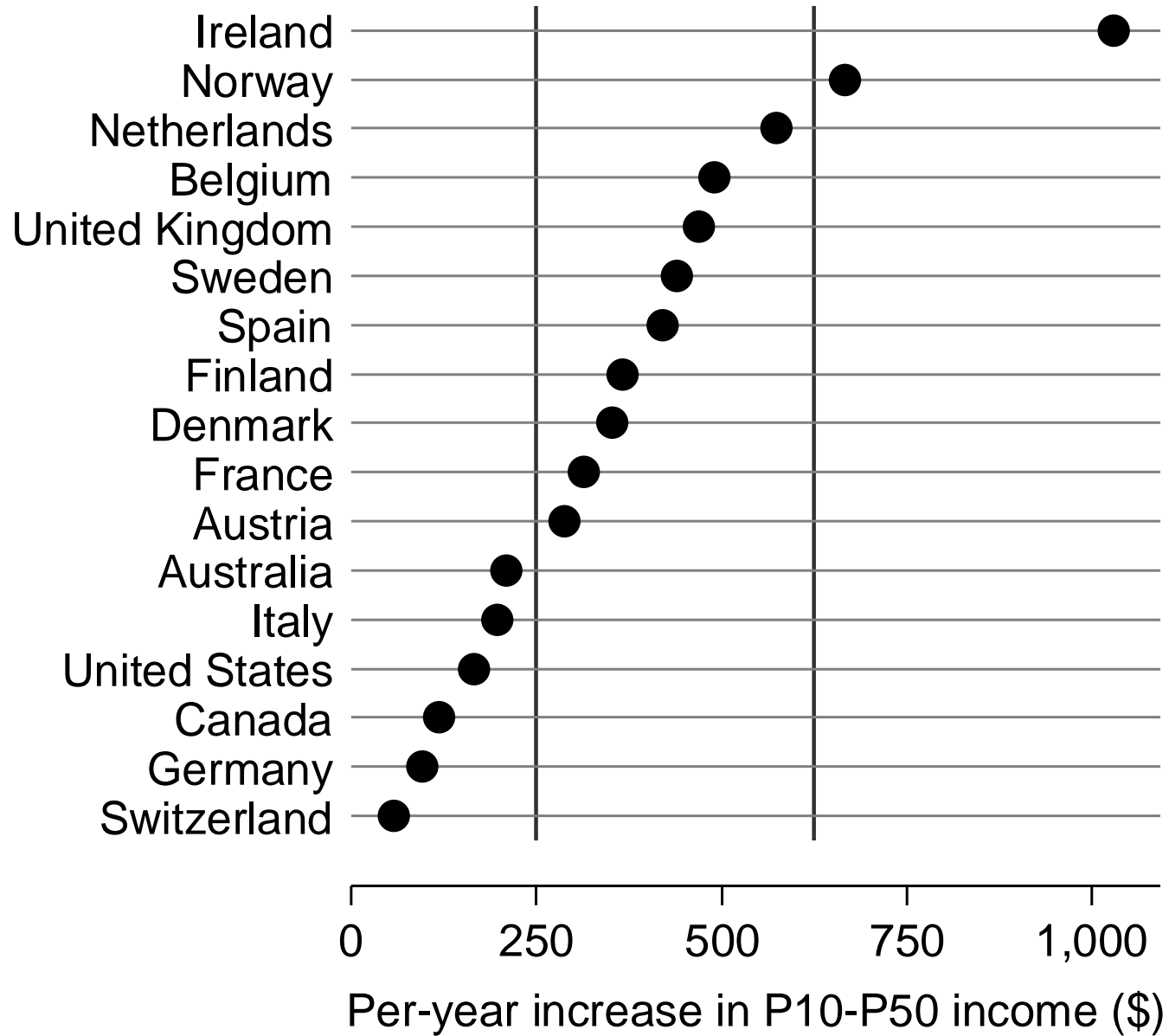
Professor Lane Kenworthy
University of Arizona

The U.S. path is not the only possible one

I'm going to step back from the US and UK to look at lessons from the broader set of rich countries

What do the data from the past several decades tell us?

Specifically, when does economic growth benefit people on low-to-middle incomes — and why?

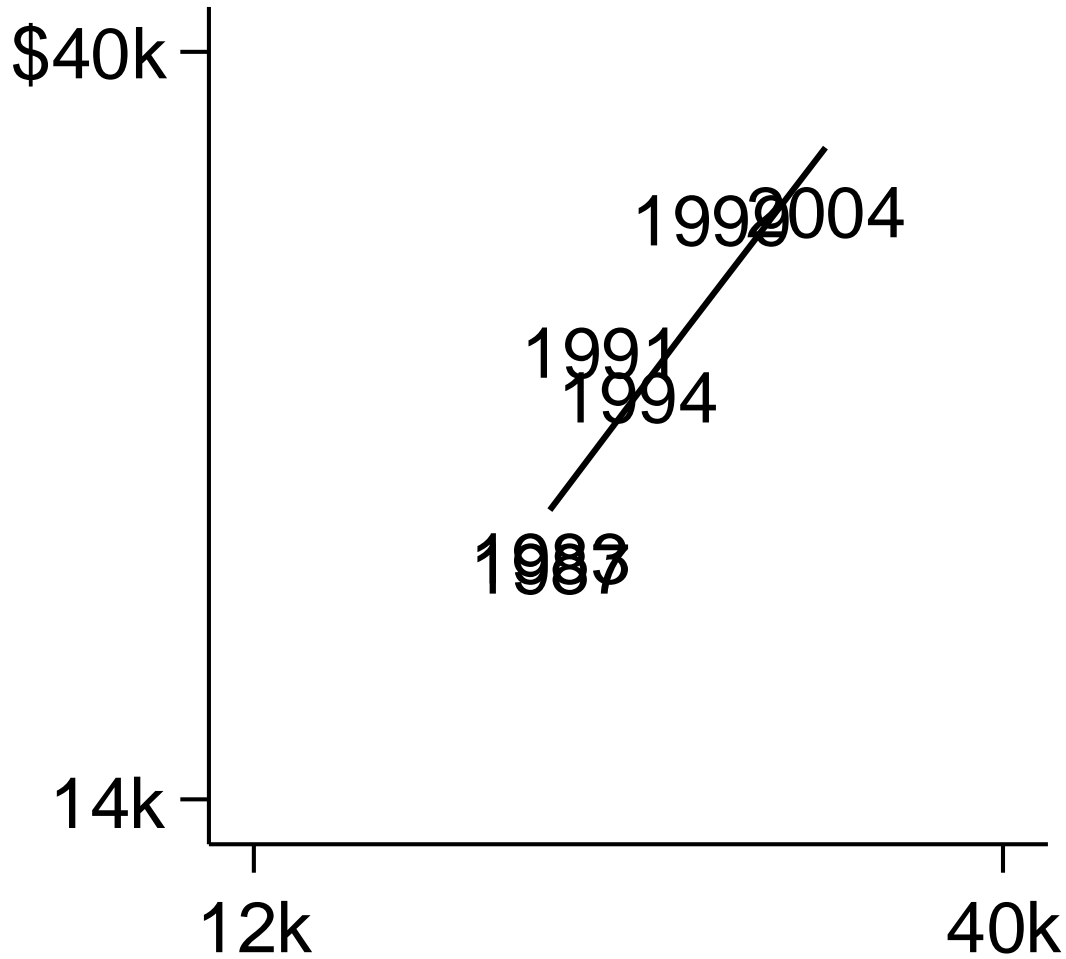


Growth of low-to-middle incomes, 1979-2005

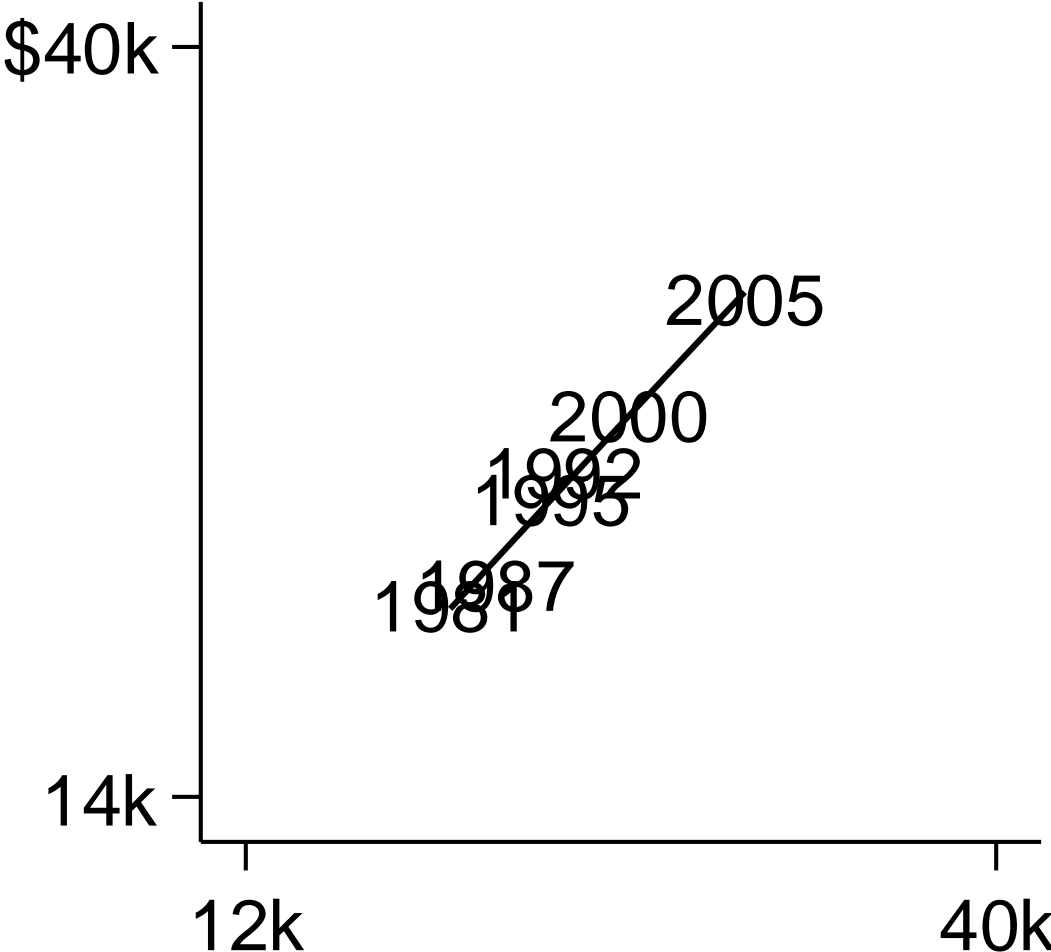
The variation across the countries owes partly to differences in the amount of economic growth

But if we exclude Ireland and Norway (special cases), about two-thirds of the variation stems from *the degree to which economic growth reaches lower-to-middle households*

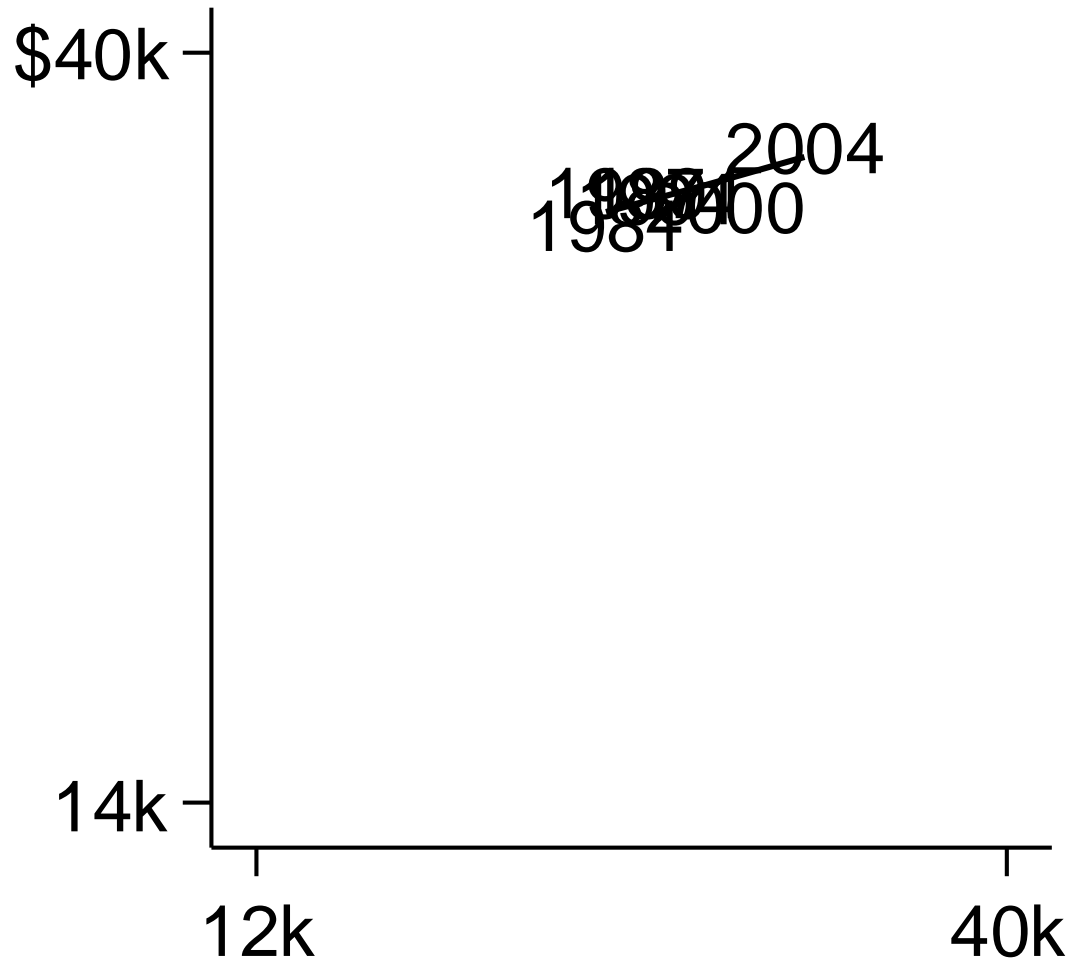
Netherlands: p10 to p50 income



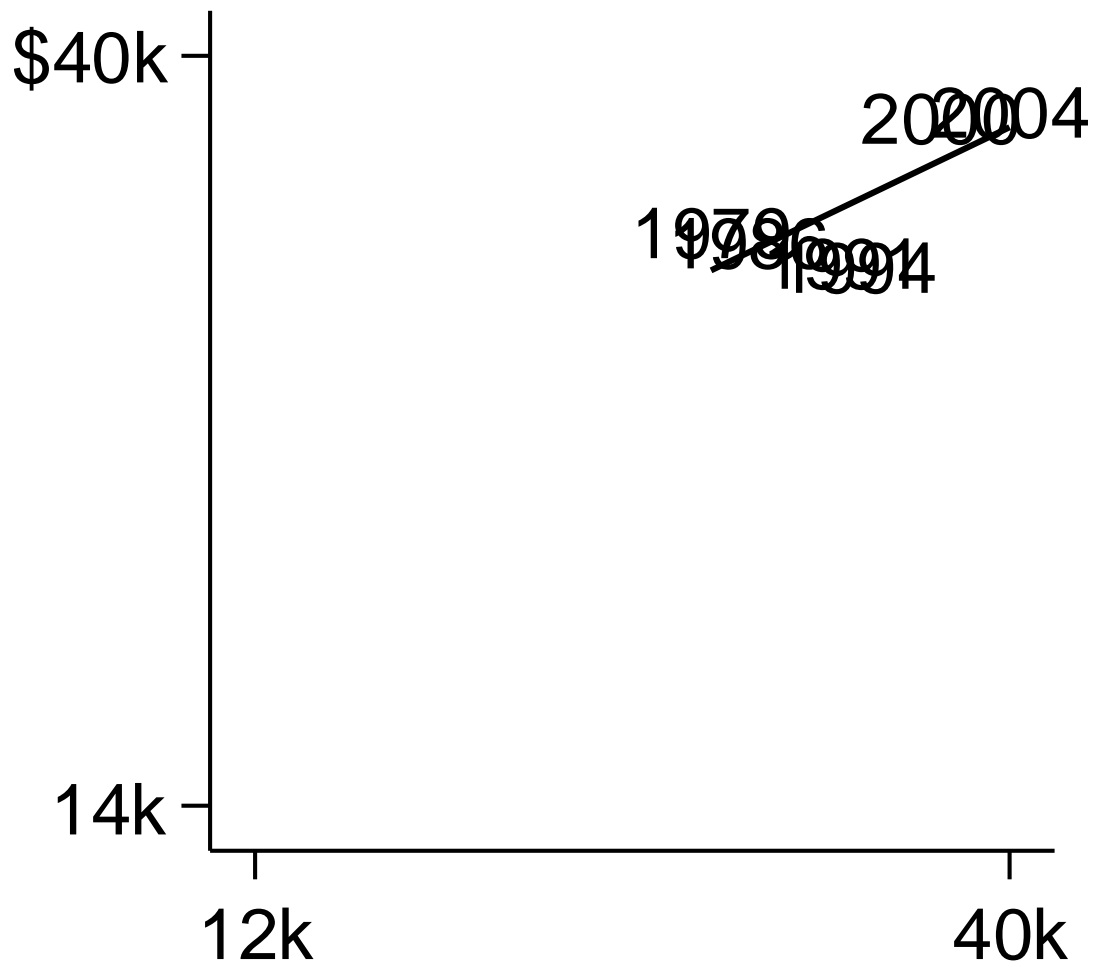
Sweden: p10 to p50 income



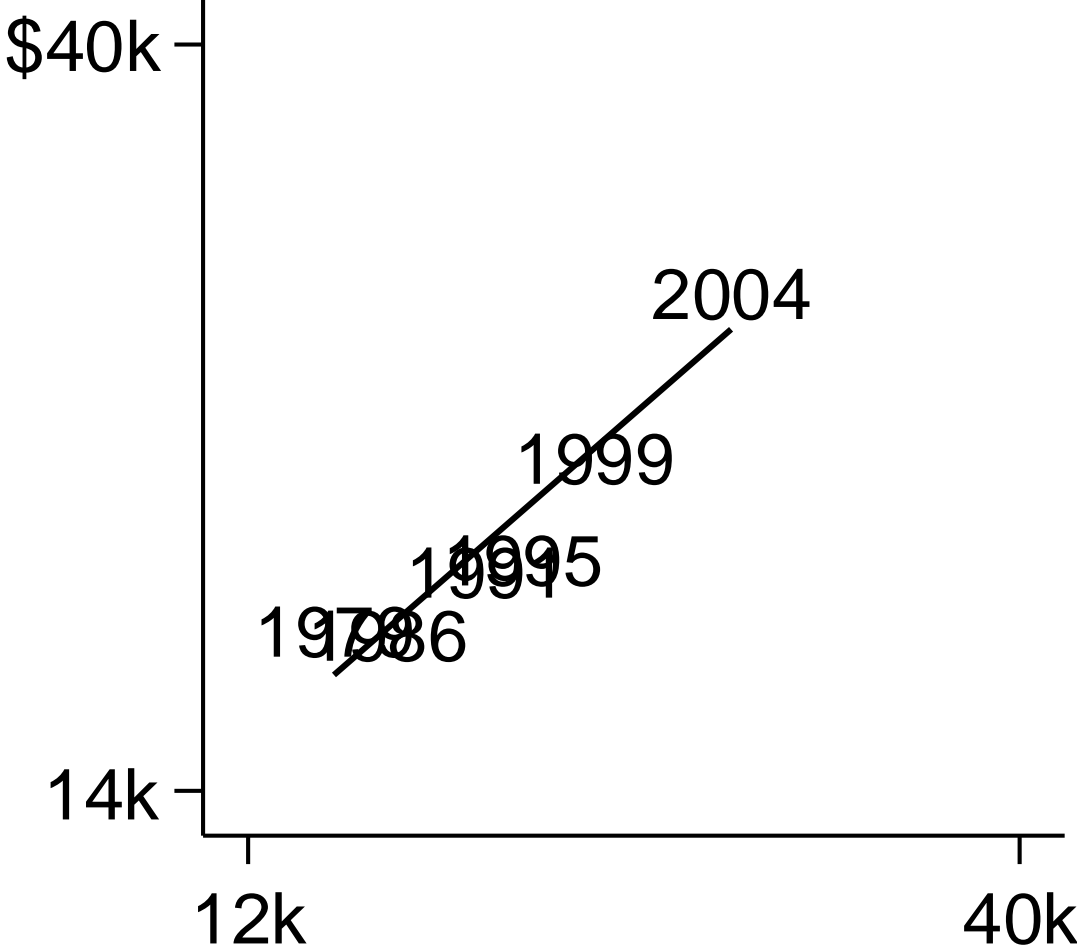
Canada: p10 to p50 income



United States: p10 to p50 income



United Kingdom: p10 to p50 income



What accounts for the cross-country differences in economic growth's payoff?

Earnings?

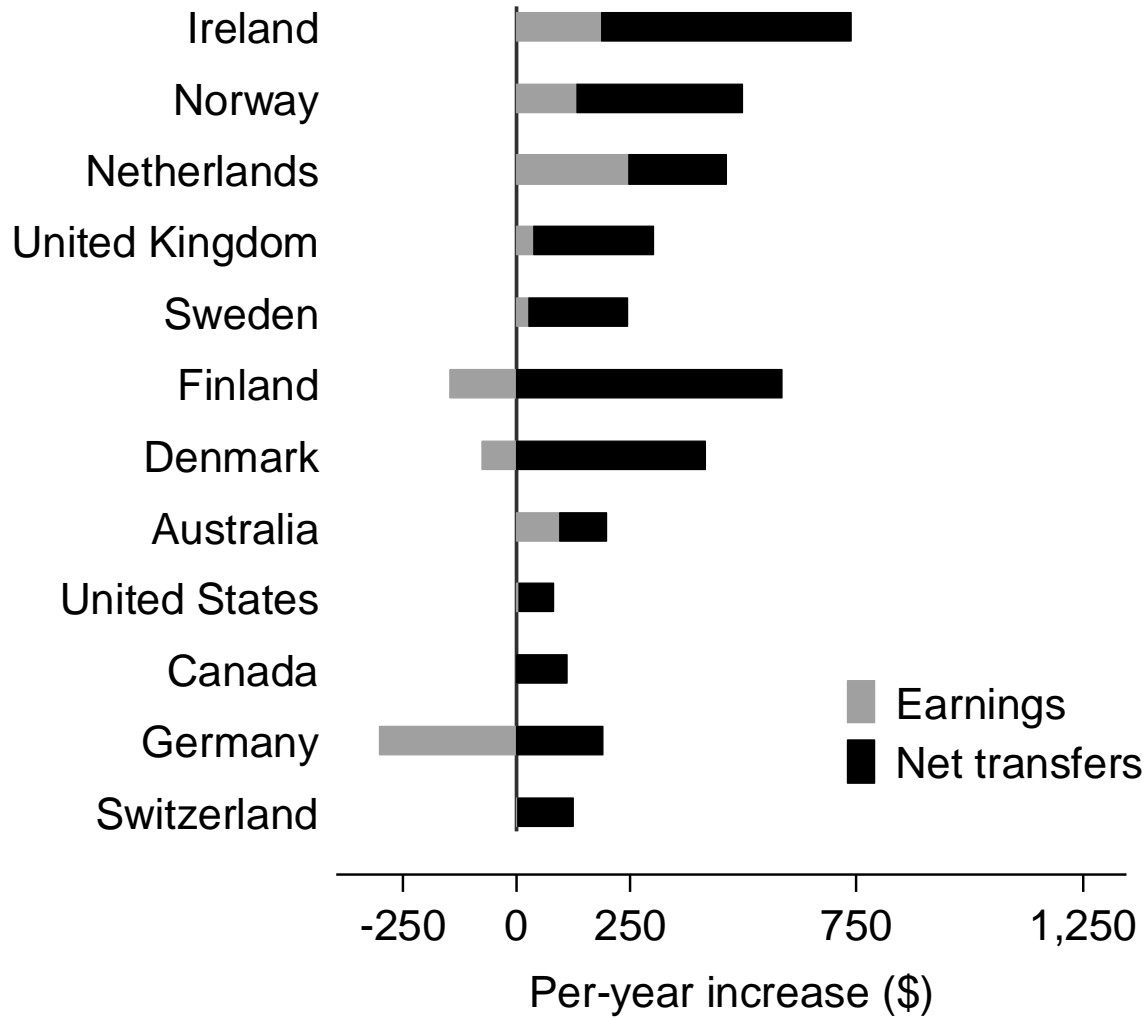
Taxes and benefits?

What accounts for the cross-country differences in economic growth's payoff?

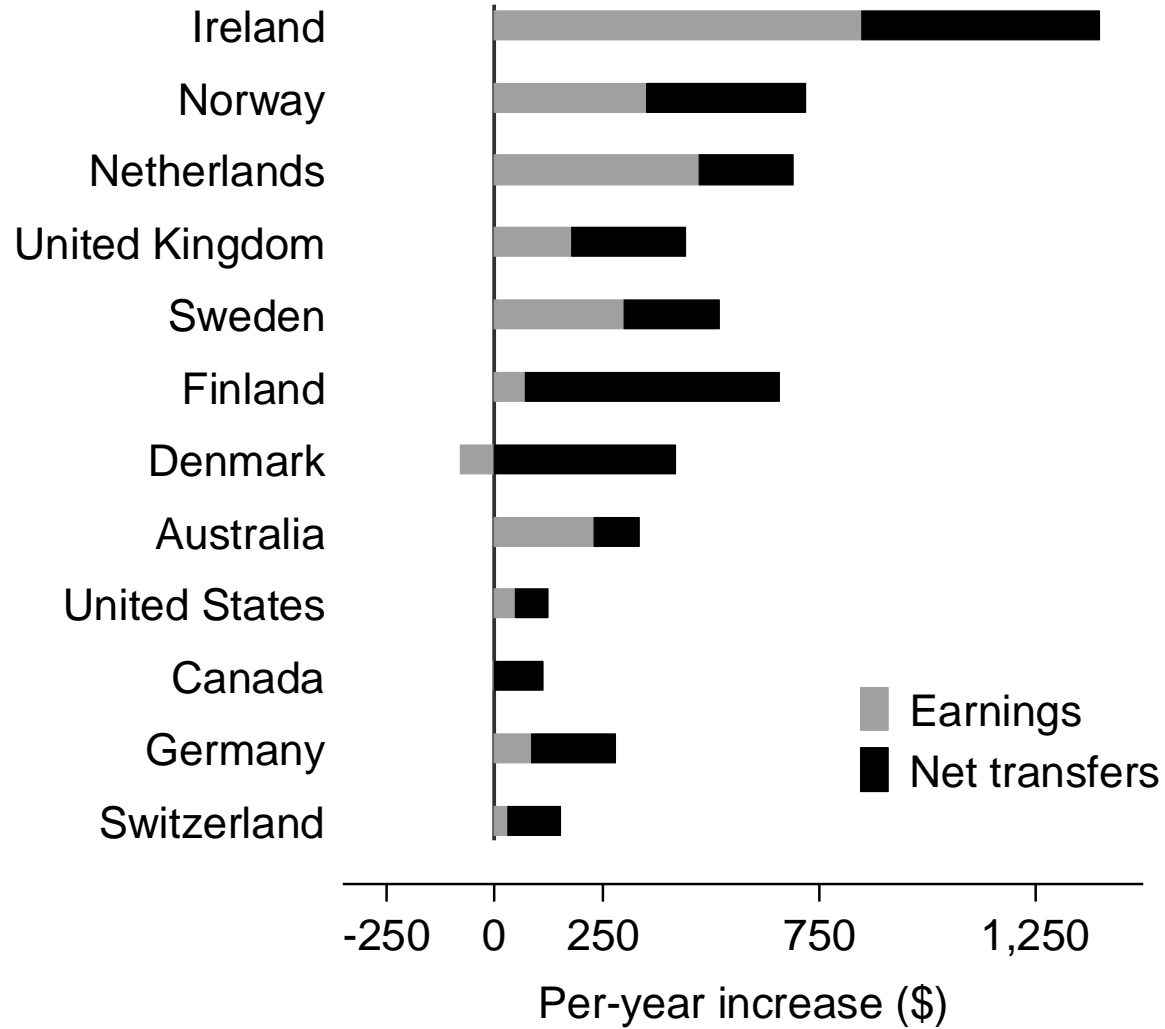
"Low income" households: net government transfers

"Modest income" households: earnings and net government transfers

P10 to P25



P25 to P50



What to do?

What to do?

Growth miracle

Ireland, Norway

What to do?

Employment miracle
Netherlands

What to do?

For most nations, in most circumstances, income growth in low-to-middle households is best achieved via a combination of

rising net government transfers

rising wages

rising employment

What to do?

Commit to ensuring that net government transfers rise in sync with the economy

Employment-conditional earnings subsidy (Working Tax Credit) is particularly helpful

What to do?

Wage growth and/or employment growth in the bottom half

What to do?

Wage growth in the bottom half

Healthy economic growth and low unemployment

Strong unions

A decent and rising statutory minimum

What to do?

Employment growth in the bottom half

Healthy economic growth

Not-too-high payroll taxes

Moderately flexible labor market

Primary and secondary schooling

Family-friendly: childcare, early education

What to do?

Relative to other rich nations, the UK did pretty well over the past generation, particularly from the mid-1990s to the early 2000s

But the international data I use end in 2004 for the UK

Other work by the Resolution Foundation suggests a less rosy picture since then

What to do?

The US experience is a stark warning

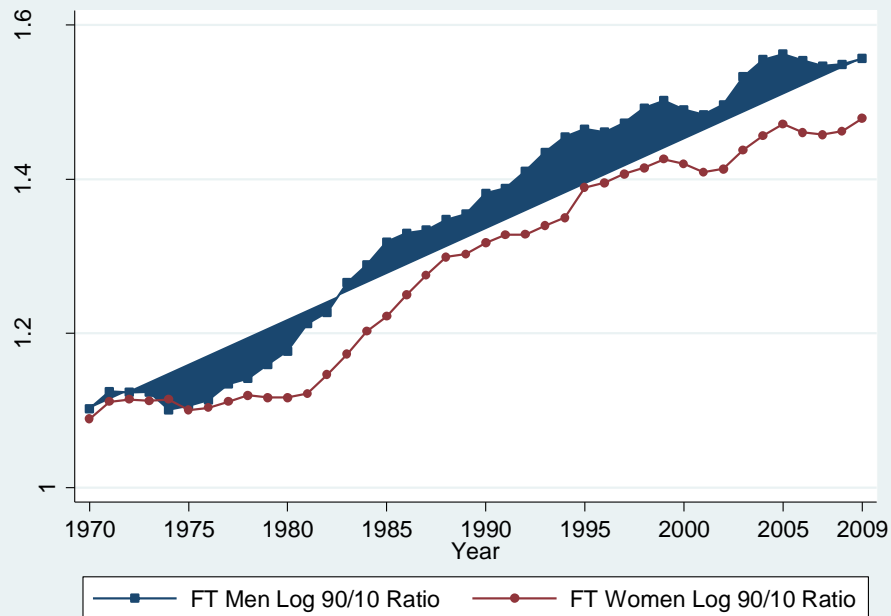
So too that of Australia, Canada, Italy, Germany,
Switzerland

Changes in UK and US Wage Inequality

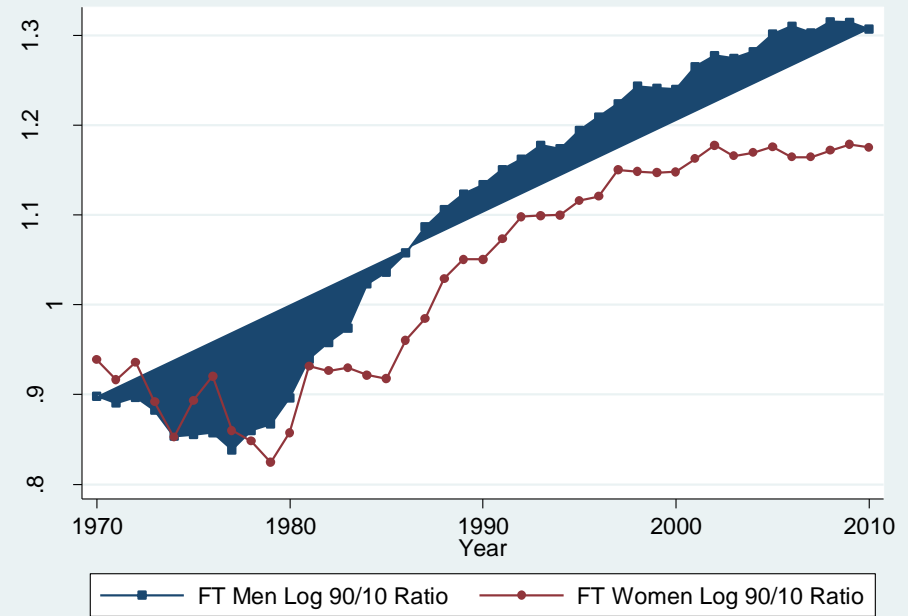
Professor Stephen Machin
Centre for Economic Performance
London School of Economic

Trends in US and GB Wage Inequality (Full-Time 90-10 Log Weekly Wages)

United States, 1970 to 2009

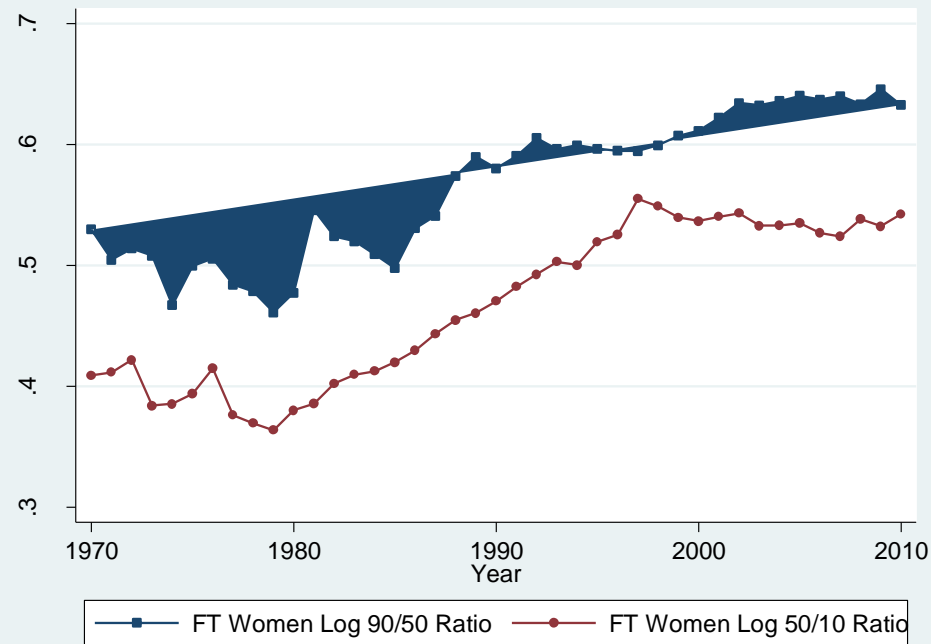
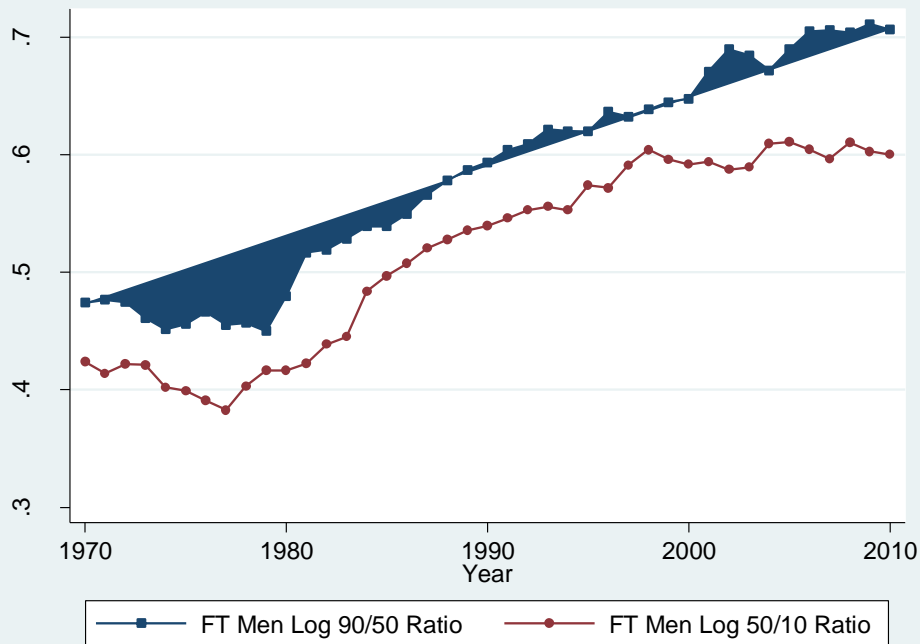


Great Britain, 1970 to 2010



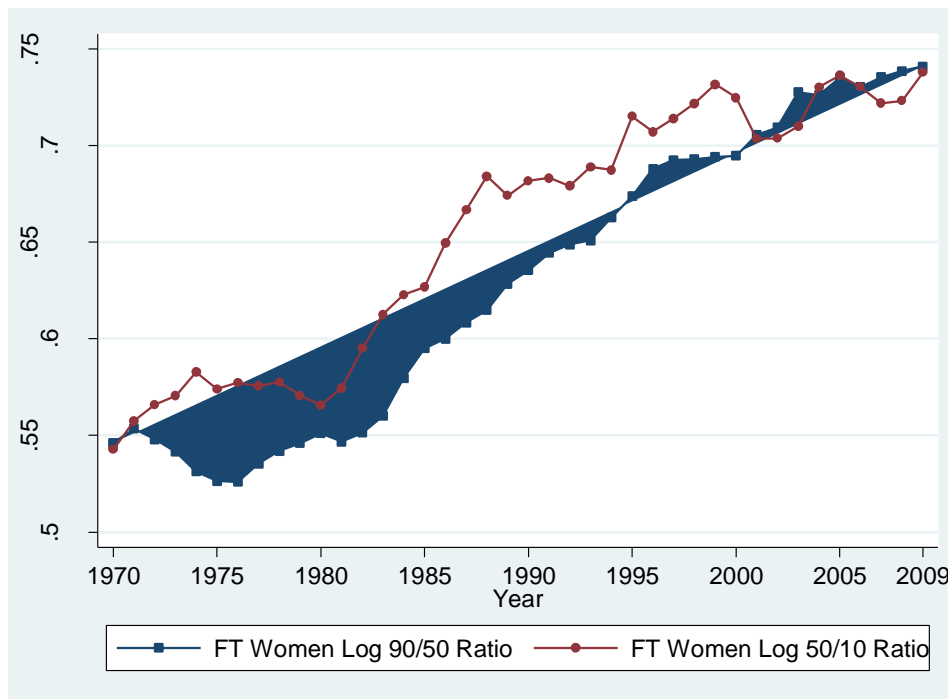
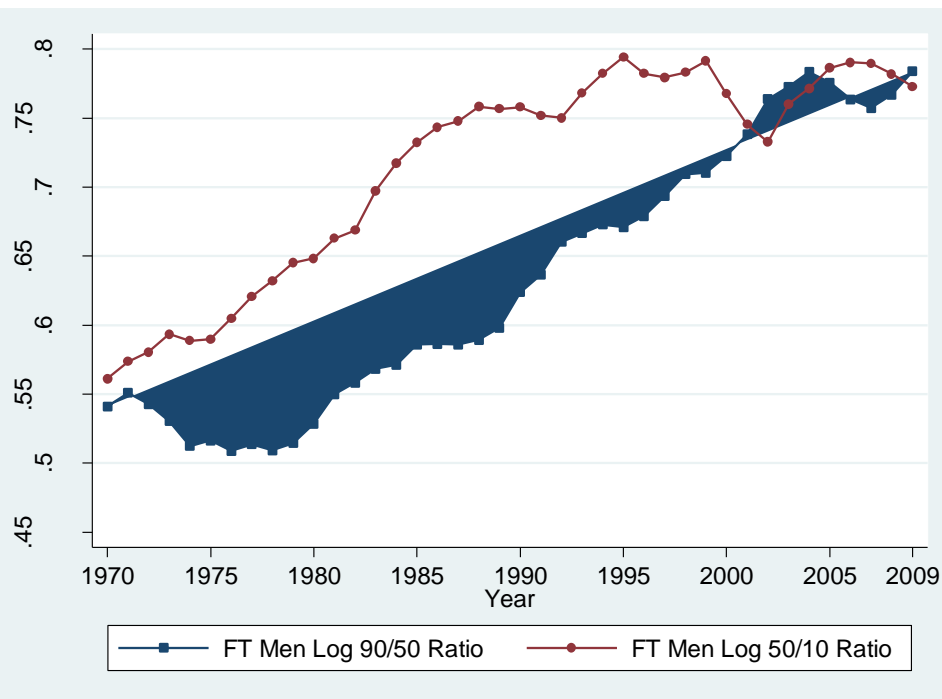
Upper and Lower Tail Inequality,

90-50 and 50-10 Log Weekly Earnings Ratios, Full-Time Men and Women, GB, 1970-2010



Upper and Lower Tail Inequality,

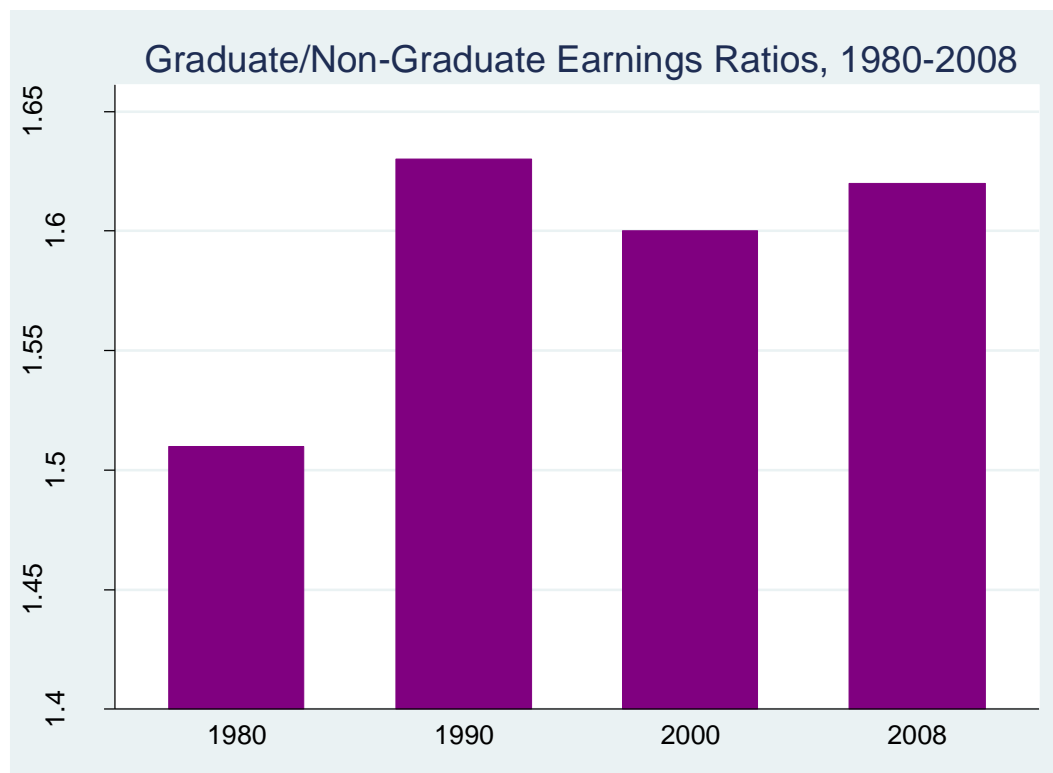
90-50 and 50-10 Log Weekly Earnings Ratios, Full-Time Men and Women, US, 1970-2009



Drivers

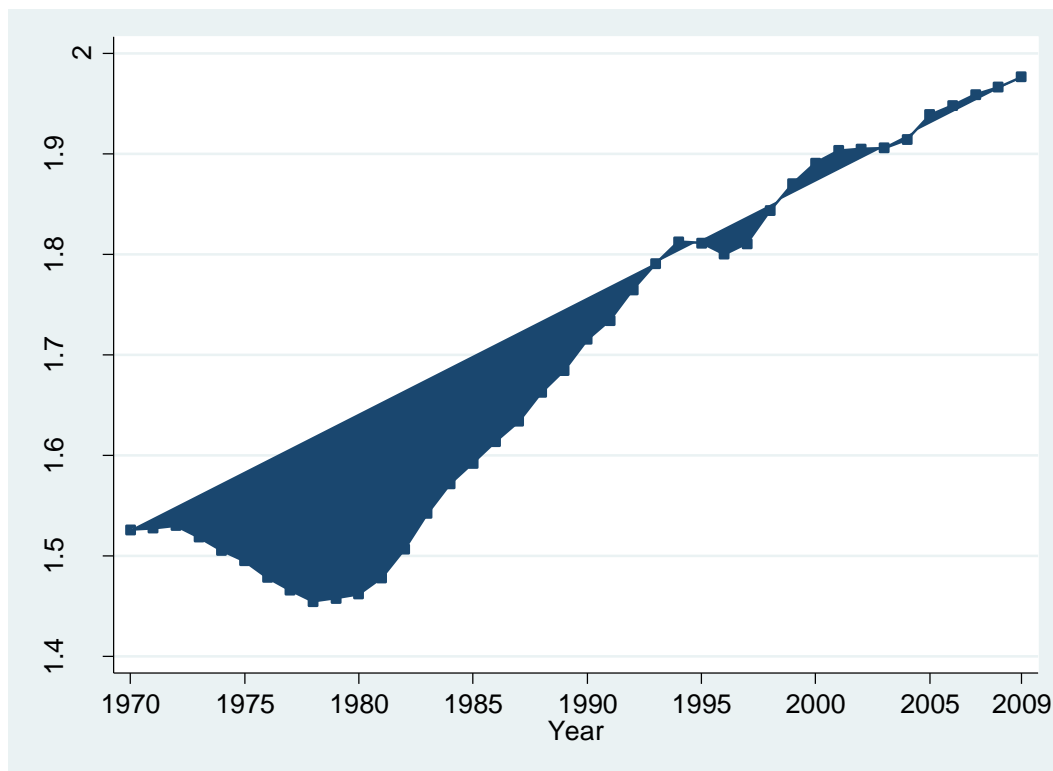
- 1). Rising educational wage differentials.
- 2). Technology and 'hollowing out'.
- 3). Minimum wages.

1). Rising Educational Wage Differentials, UK



Notes: Graduate/non-graduate full time earnings ratios derived from General Household Survey data.

1). Rising Educational Wage Differentials, US



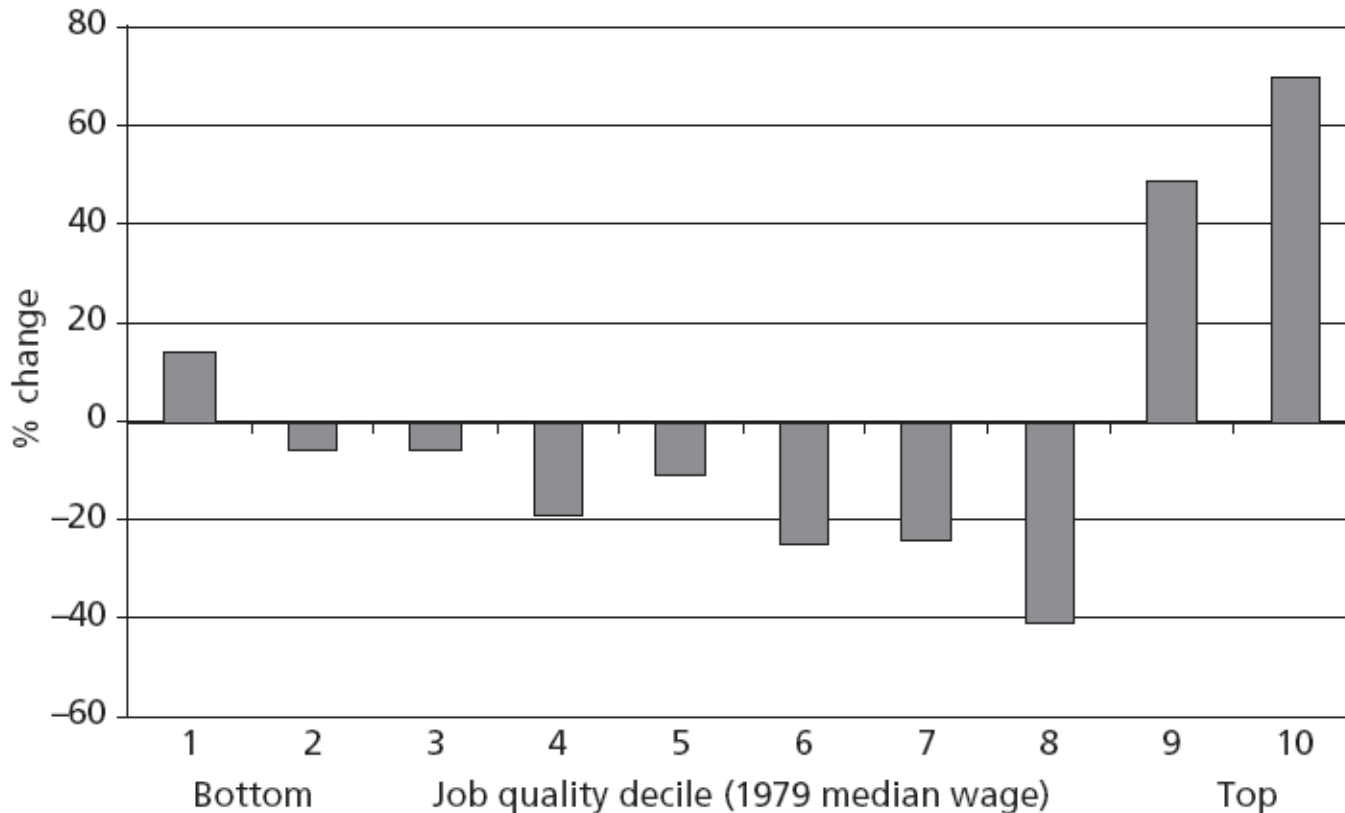
Notes: College/High School full time earnings ratios derived Current Population Survey data.

2). Polarization of Labour Market

Demand shifts favour the skilled (doing jobs with non-routine tasks), but routine non-manual tasks (e.g. clerical work) may be replaced by computers, whilst some non-routine tasks done by manual workers (like cleaning) are largely unaffected.

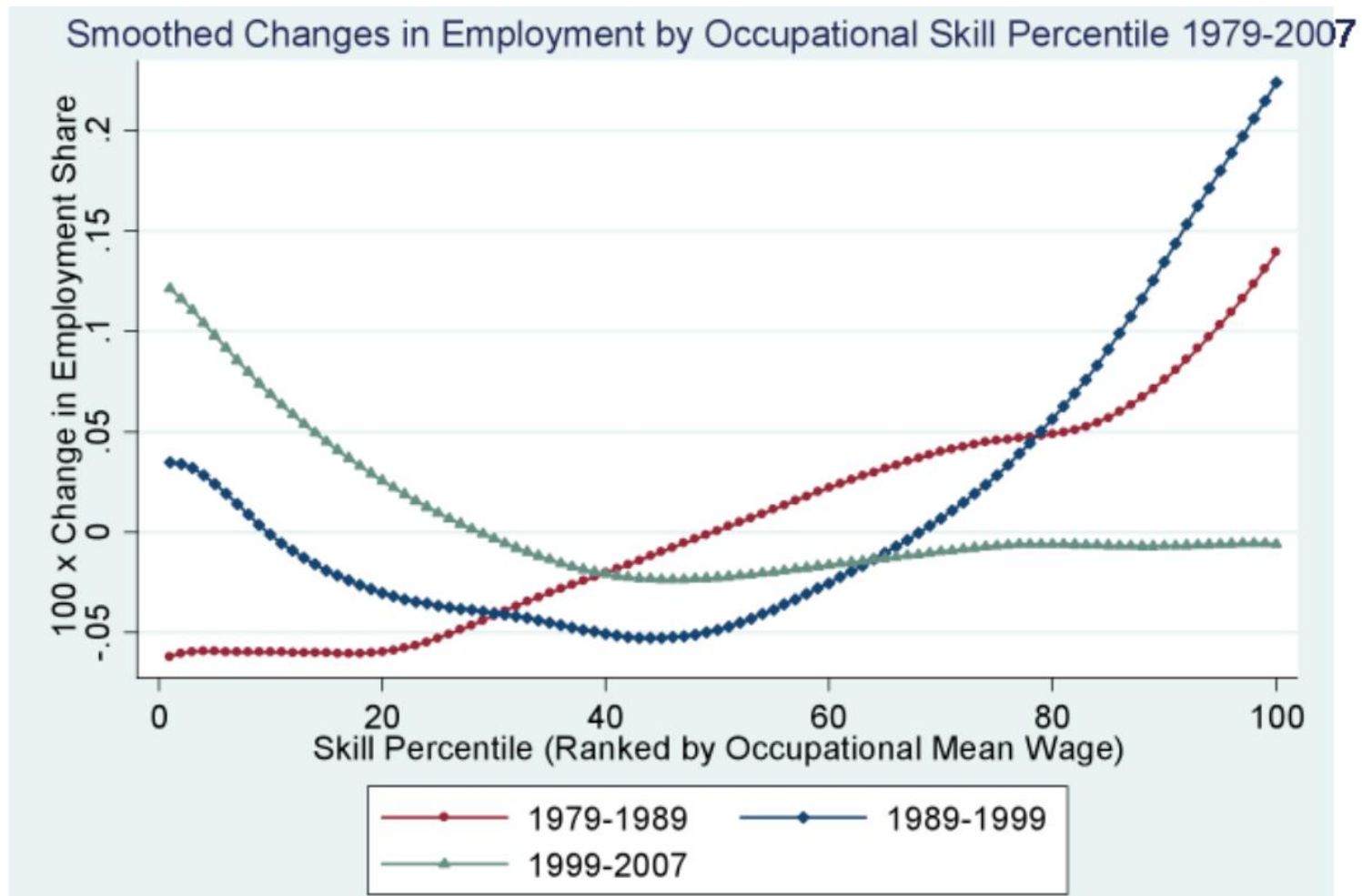
Leads to polarization of labour market – loss of jobs from middle part of the distribution.

2). UK Labour Market Polarization – Changes in Job Growth by Job Quality Decile, 1979-2008



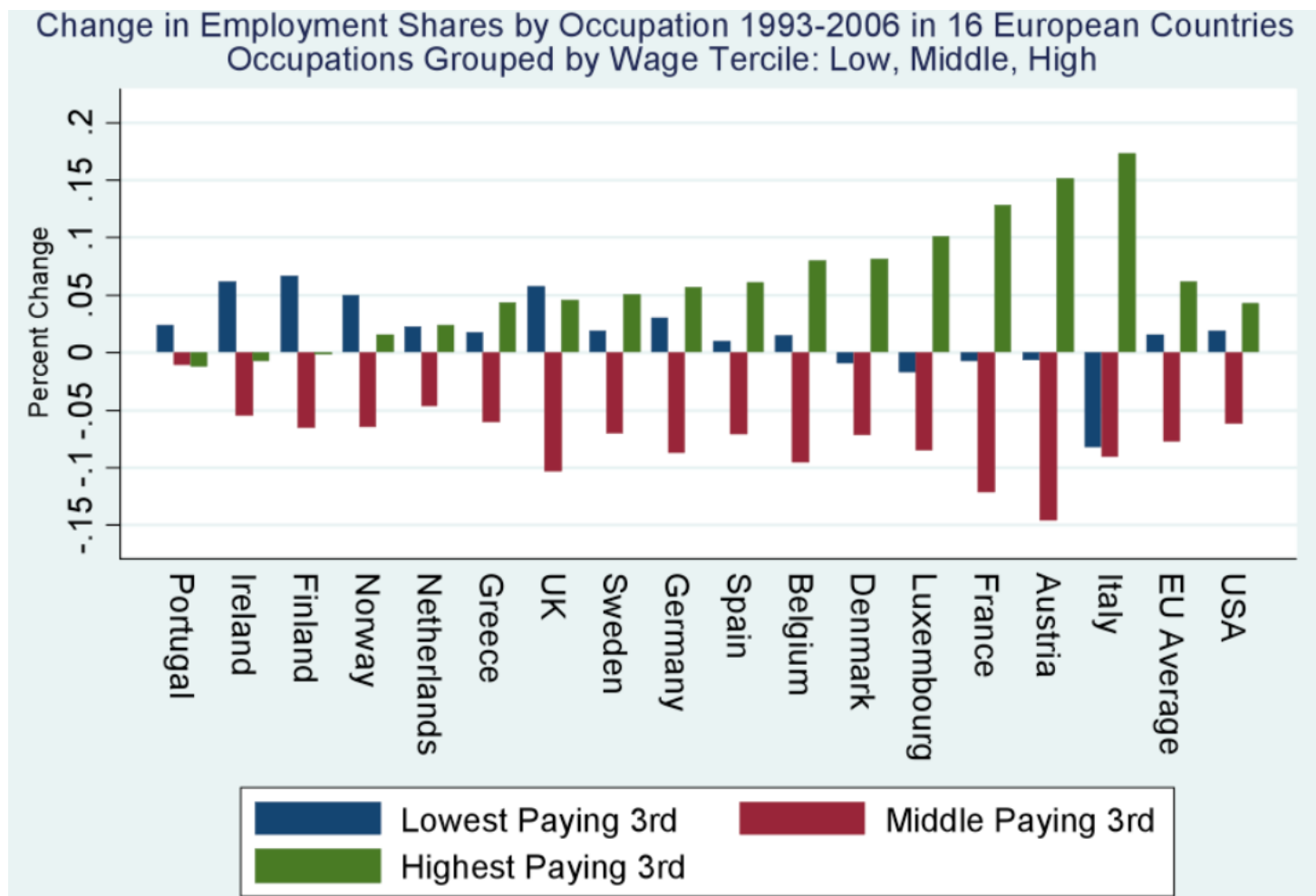
Notes: Taken from Mieske (2009). Percent changes are for the entire period.

2). US Labour Market Polarization



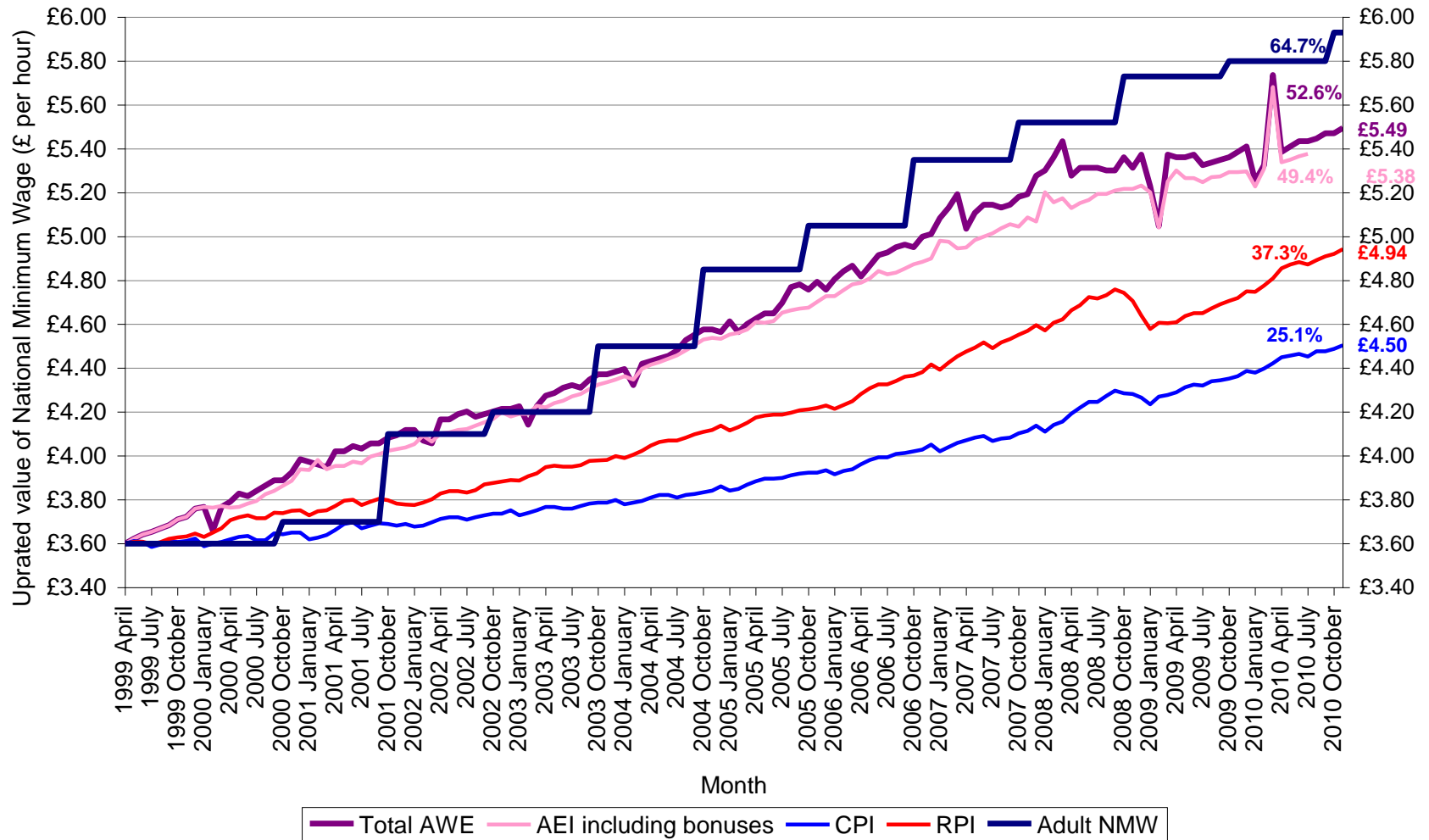
Notes: Taken from Autor, Katz and Kearney (2008).

2). International Patterns of Polarization



Notes: Taken from Goos, Manning and Salomans (2009).

3). The UK National Minimum Wage



Source – Low Pay Commission

Discussion

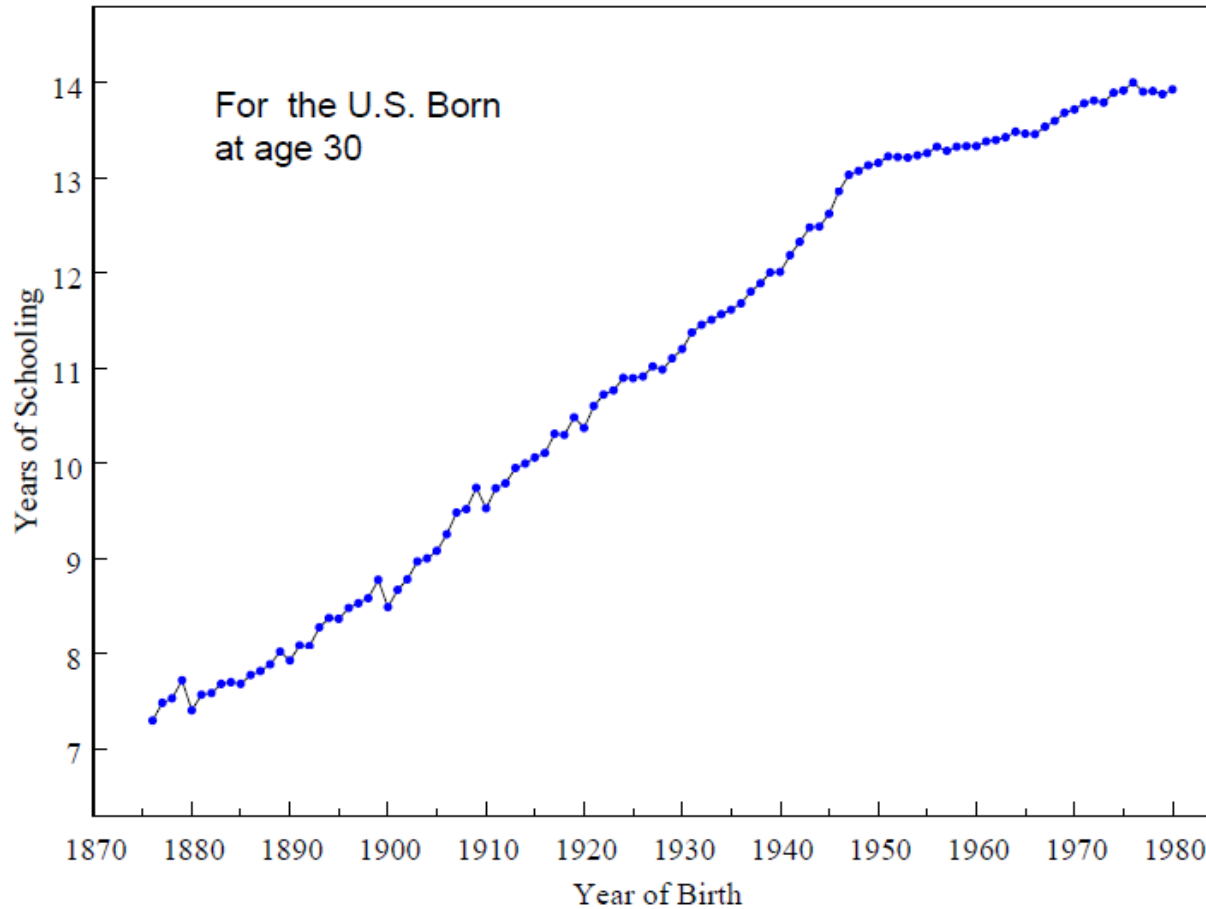
Discussion: for the UK, there are some warning signs from the patterns of change in the US.

a) slowdown in years of education and the continued rise in educational wage differentials

b) no growth in real wages at the median for the last thirty years.

a) The US Slowdown in Education

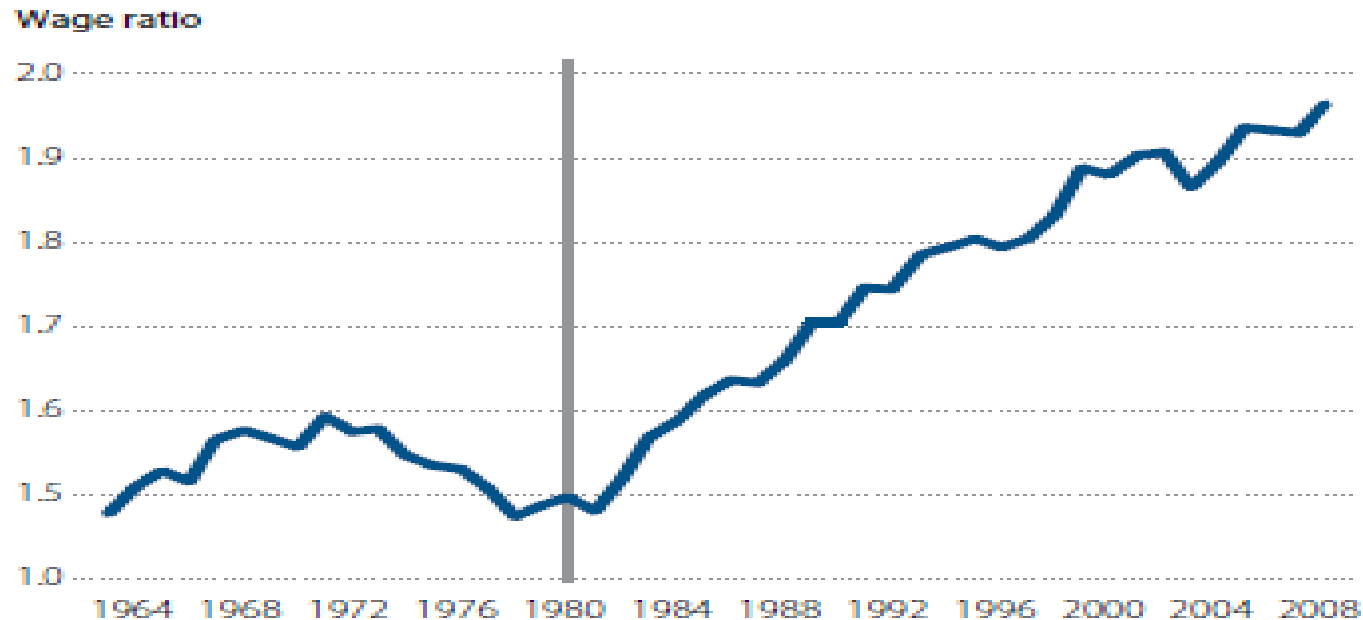
The Human Capital Century: Mean Years of Schooling by Birth Cohort



Source: Goldin & Katz (2010), IPUMs, MORG

a) And The Coincident Rise in the US College Wage Premium

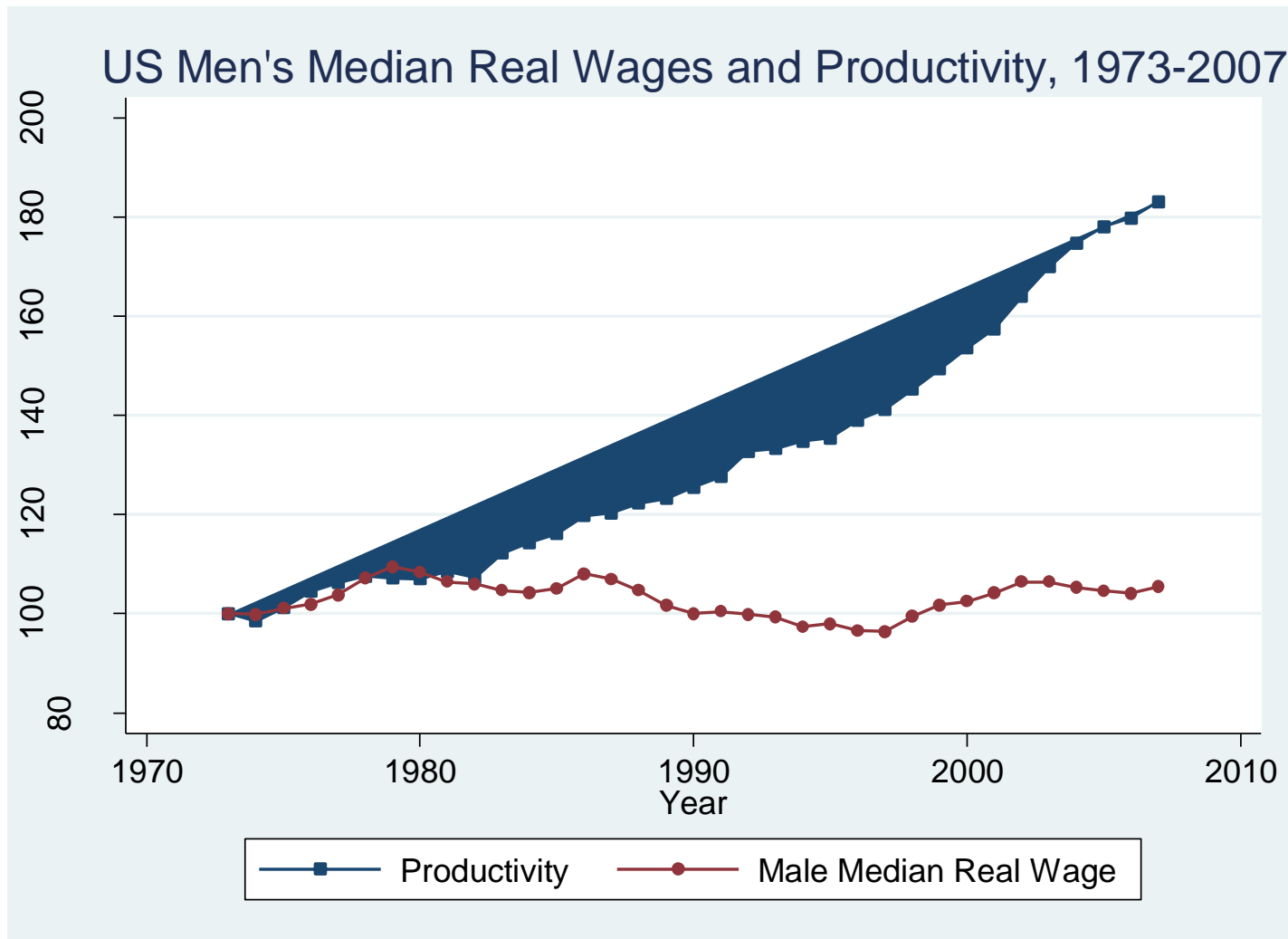
College degree vs. high school diploma weekly wage ratio, 1963–2008



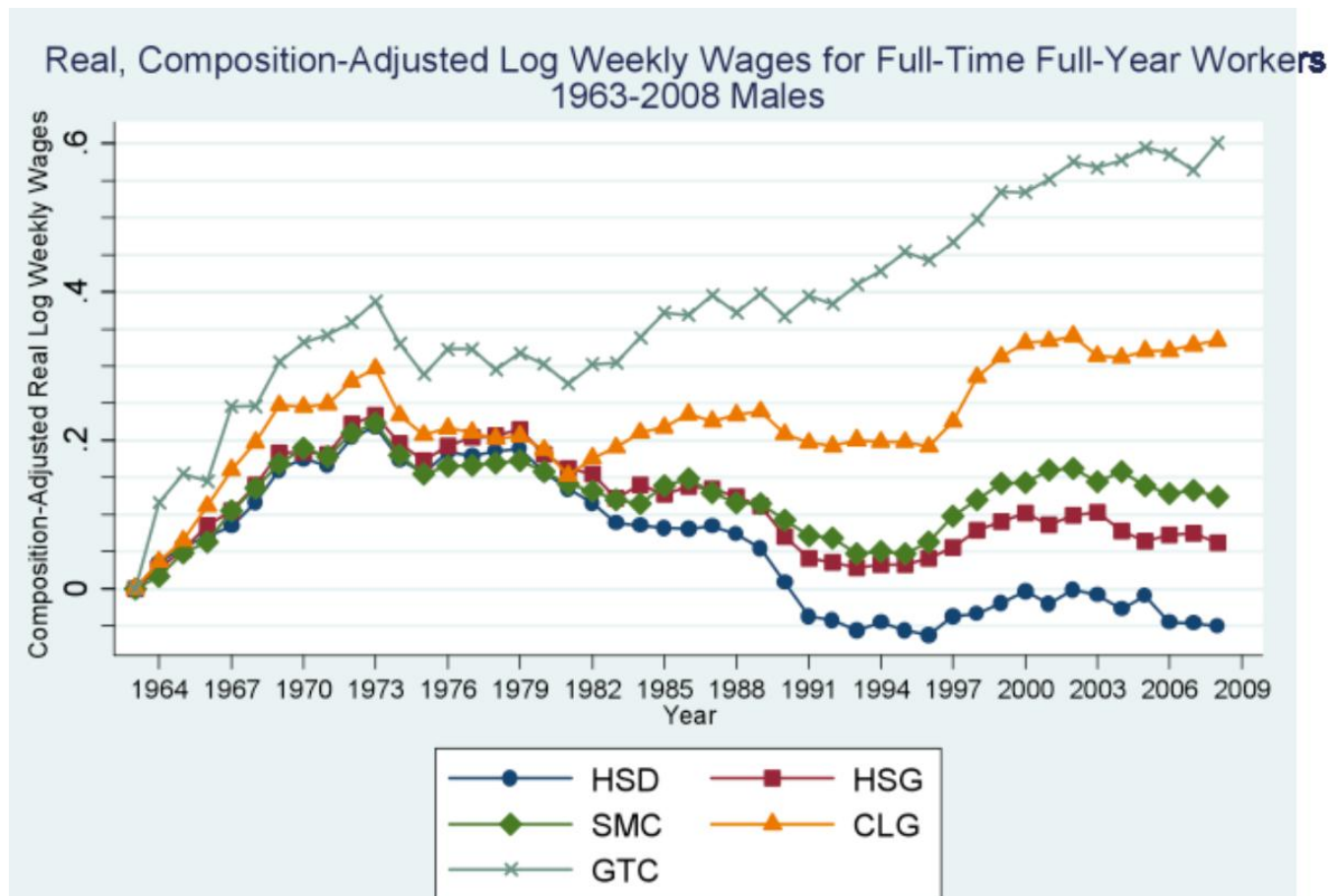
Source: Acemoglu & Autor (2010), March CPS, log(weekly wages) for full-time full year workers.

of the relevant composition adjusted cells using a fixed set of weights equal to the average employment share of each group. The exponentiated ratio of mean log wages for college and high school graduates for each year is plotted.

b) US – Flat Real Wage Growth at the Median



b) US – And Big Variations by Education



GTC – Postgraduates; CLG – College Only; SMC – Some College;
HSG – High School Graduate; HSD – High School Dropout

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